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Editorial Comment

Progress of Assessment and Taxation Work

Accountants still argue about the speed of work of the tax department at Ottawa, and no doubt will continue to discuss the matter as long as Ottawa collects taxes from their employers or their clients. Needless to say, the argument in recent years has tended towards severe criticism of the department. It often has shown little consideration for the stupendous task, through shortage of staff at a time when volume was multiplied, rates sharply increased, and numerous complications thrown into the bargain. That the department should get behind was almost inevitable, and probably a similar situation exists in other countries. In August we reproduced taxation statistics then published by the department, and they included the following figures:

Assessments for Taxation Year	Made in Government Fiscal Year ended March 1942		March 1943	
	Individual	Corporation	Individual	Corporation
1939	95,249	4,974	—	—
1940	291,931	4,097	316,468	6,573
1941	545	105	325,126	3,273
1942	—	2	532	109
1943	—	—	—	1
	387,725	9,178	642,126	9,956

While the picture of this wartime rise in tax work is not complete without the corresponding figures for at least two more years, it at least is evident, from the above and from other sources, that there was quite a bottleneck in the checking of returns for 1940, 1941 and probably 1942, which were the years in which income taxation was multiplied in scope. That would mean that until about 1944 the department was running behind. Since then it is understood to have been catching up. A great many individuals during 1945 have received clearances for 1941 and 1942. We are informed that from April to September 1945, that is in the first six months of the government current fiscal year, no less than eight thousand corporation assessments were made, and that even more than this number should be disposed of in the current six months; since there are less than 10,000 tax paying corporations, that means speeding up in this branch of the department's work.

We are also informed that a report giving the statistics for a further year will be available by early January.

Training and Jobs

We have just received the voluminous report of a Royal Commission on Veterans' Qualifications, which includes recommendations numbering no less than eighty-two. Recently the R.C.A.F. issued a "booklet" of 166 pages entitled "Employers' Guide" listing the training and qualifications of men in all sections of the air force. These are only samples of the elaborate machinery set up for the maintenance, training and placement of ex-servicemen. They indicate the emphasis placed on the problem of "rehabilitation" in this postwar period. But do we forget the all important fact that employment, and all the training and maintenance leading up to it, is dependent on jobs, and that jobs in turn are dependent on opportunities? Does the desire of men to get back from overseas as quickly as possible mean a race of an over-supply of men for an under-supply of jobs? The way in which the employment statistics have turned the corner within the past three months, from a surplus of jobs to a shortage of jobs, suggests that an unemployment situation is developing already. If that is so, taxation should be modified and business stimulated. The current budget changes ease the strain on business and on individuals, but

considerably more will have to be done. What Canada needs, for this critical postwar period, is a vigorous expansion of private enterprise.

The Senate Tax Inquiry

The Senate committee on the Income War Tax Act held its opening session on October 14, when the scope of the inquiry and plans for conducting it were announced. No matter what the government may do later, this Senate investigation probably is the opening phase of reform of our entire tax structure. Taxation in Canada is a maze of conflicting principles, duplicate jurisdiction, and overlapping rates. The situation demands simplification, modification in some respects, and efficiency in administration. Piecemeal experiments are quite inadequate.

Foreign Trade and Its Settlement

From the time of the Atlantic charter, it was generally accepted that the end of the war would usher in a new era in which international commerce would be freed, not only from the restrictions arising out of the war itself, but also from the shackles in the form of high tariffs, quotas, embargoes and blocked currencies, which had hampered it during the period of extreme nationalism which intervened between the two wars. Now that the war is over, the time has arrived to implement this plan, yet apparently the nations are loath to do it. Instead, we have a lot of unsatisfactory theorizing about the principles of foreign trade, and of arguments which all too clearly imply a return to nationalist extremes. The imperial preference, which was under discussion at a conference in London in recent weeks, is itself one of the barriers to freedom of trade, while in the United States, which through high tariffs tended to establish a one-way trade in American goods, the discussion continues on the subject of how American goods can be marketed for value without taking something in return.

It is astonishing how such a fundamentally simple thing as trade has been swayed by so many brands of economic theory. From the primitive barter, which was exemplified as late as the nineteenth century by the trader who took European gadgets or cotton goods to the Pacific and brought

back a load of copra, we passed to an era in which the whole business of commerce was boggled by mercantilists who argued that the way for a nation to grow rich was to sell for gold and then hoard it. After the first world war we discovered what was unhappily termed "maldistribution of gold" and tried credit, only to find that selling internationally on credit in many cases was not selling at all. War relations of course have had something to do with this. Now we are disentangling the trade relations of world war number two, but are still involved in the contracts of UNRRA, UNO, and other new international bodies. What may come out of the Bretton Woods conference on currencies, as far as concerns international trade, remains to be seen, but there is today a tendency to view commerce as a bookkeeping operation which may be kept in balance, not necessarily by settling in gold or in paper currency, but by a process of altering trade regulations and quotas. When we view the complications of international trade, and especially when we hope that it may be increased so that people of many countries may prosper, we feel grave doubts about the ability of any authority to perform this operation. There should be greater safety in a plan which once again would permit individuals and corporations to produce, sell and collect with the widest degree of freedom, and under which recourse to a governmental agency would be the exception rather than the rule.

The Cohen Report

In this issue we publish two informative articles regarding the report of the British Board of Trade committee on company law amendment, which was headed by Mr. Justice Cohen. It will be of interest to our readers to know that the government of the United Kingdom is drafting legislation to implement in full the recommendations of the committee.

Accounts and Audit Recommendations of the British Committee

By G. P. Keeping, C.A.
Montreal, P.Q.

DOMINION company law has always followed fairly closely the company law of the old country. From time to time the acts of the two countries have been amended or re-enacted with the result that the more advanced thought has been reflected in the legislation of the country which has the more recently amended or re-enacted its companies act.

Company law in Great Britain at the present time is based on the Companies Act of 1929. The Dominion Companies Act enacted in 1934 and amended in 1935, which is our authority, in its accounts and audit provisions gave us the benefit both of the experience gained from the working of the 1929 act and of the advance in accounting thought during the interval between the two acts.

The publication, therefore, in Great Britain of the Report of the Committee on Company Law Amendment which was presented by the president of the Board of Trade to Parliament in June of this year cannot fail to be of interest to members of the profession in Canada.

The keynote of the report can be said to be fuller disclosure and this is best illustrated by quoting one of the introductory paragraphs of the report.

"We are satisfied by the evidence that the great majority of limited companies, both public and private, are honestly and conscientiously managed. We believe that the system of limited liability companies has been and is beneficial to the trade and industry of the country and essential to the prosperity of the nation as a whole. The Companies Acts have been amended from time to time to bring them into accord with changing conditions, but if there is to be any flexibility opportunities for abuse will inevitably exist. We consider that the fullest practicable disclosure of information concerning the activities of companies will lessen such opportunities and accord with a wakening social consciousness. Accordingly, while in making our recommendations we have borne in mind the importance of not placing unreasonable fetters upon business which is conducted in an

efficient and honest manner, we have included a number of proposals to ensure that as much information as is reasonably required shall be made available both to the shareholders and creditors of the companies concerned and to the general public. We have also sought to find a means of making it easier for shareholders to exercise a more effective general control over the management of their companies. The result will be, we believe, to strengthen the already high credit and reputation of British companies. We must emphasize, however, that this objective will be attained more by the selection by the shareholders of the right governing body of each company than by the provisions of any statute."

Inevitably fuller disclosure to a very large extent can best be achieved through the medium of the accounts and it is not surprising, therefore, to find that the recommendations dealing with accounts are both numerous and far reaching.

Another interesting highlight of the report is a recommendation which is closely related to a problem exercising our minds and those of our brothers in the United States, to wit the closing of the profession. The committee recommends that, in so far as auditing of limited companies is concerned, the profession be closed.

In the following paragraphs it is proposed to outline some of the more important recommendations affecting accounts and audit. Marginal references to the relevant section of the Dominion Companies Act are given as well as references in brackets to the British Companies Act.

Books

Sec. 111 (Sec. 122). No far reaching changes regarding the books to be kept by a company are recommended by the committee. It is recommended, however, that a subsection be added very much along the lines of subsection (3) of the Dominion act regarding the records of operations outside Canada.

Balance Sheet

Sec. 112 (Sec. 124). The Companies Act of 1929 dealt in very general terms with the information to be disclosed in the balance sheet and it will be recalled that the subsequent Dominion Companies Act of 1934 enumerated in far greater detail the various classes of assets and liabilities to be distinguished severally in the balance sheet. Allowing for differences in terminology between the two countries the

recommendations of the committee provide for essentially all the detail called for by the Dominion Companies Act.

The most interesting feature, however, is in the committee's treatment of reserves. The recommended amendment to the act defines three classes of reserve and provides that each class shall be shown separately on the balance sheet. The three classes correspond roughly to capital surplus, in its normally accepted sense, general reserves and reserves for contingencies. By defining those items the committee's recommendations go beyond our act and for that reason the definitions are quoted below:

(a) "The aggregate, if material, of any capital reserves, defined as any amounts which, whether or not they were originally set aside as provisions to meet any diminution in value of assets, specific liability, contingency or commitment known to exist as at the date of the balance sheet, are not retained for that purpose and are not regarded as free for distribution through the profit and loss, or income and expenditure account."

(b) "The aggregate, if material, of other reserves defined as any amounts which, having been set aside out of revenue, or other surpluses, are free in that they are not retained to meet any diminution in value of assets, specific liability, contingency or commitment known to exist as at the date of the balance sheet."

(c) "The aggregate, if material, of provisions which, not being provisions for the diminution in value of assets, have been set aside out of revenue or other surpluses, and are retained to meet, in cases where the amounts cannot be determined with substantial accuracy, any specific liability, contingency or commitment known to exist as at the date of the balance sheet: Provided that—

(i) the amounts retained as provisions, whether for the foregoing purposes or for diminution in value of assets, shall not exceed such amounts as in the opinion of the directors are reasonably required for the purpose;

(ii) in any case where the Board of Trade are satisfied that such disclosure would be prejudicial to the company's interests and is not required in the public interest, the amounts concerned need not be shown separately but may be included under other headings if appropriate words are introduced to

indicate that provisions of this character are included therein."

The committee's attitude towards fuller disclosure is clearly seen in the above proviso (i), which embraces not only any reserve for contingencies, but also any amounts set aside for diminution in value of assets and, presumably, deducted from those assets on the balance sheet. It is noteworthy that the report states later that such banking companies and discount companies as the Board of Trade may designate and assurance companies shall not be compelled to show such reserves separately but that banking companies and discount companies shall indicate by appropriate words where reserves and provisions are included under other headings.

The recommendations enumerate in some detail items which shall be dealt with by way of note on the balance sheet or in any statement or report annexed thereto. Most of the items so enumerated either fall into the category of contingent liabilities or are notes which are called for by good accounting practice, but two of them are worthy of mention here. In the case of a holding company a note is required of any shares or debentures of the holding company held by subsidiary companies. The second item is that comparative figures for the immediately preceding balance sheet shall be given.

Profit and Loss Account

Sec. 113. The 1929 act is almost completely reticent on the subject of the profit and loss account and this fact is recognized by the committee. Again, the recommendations give reason to believe that a leaf has been taken from our book, amongst others, and modernized. For instance, the influence of the United States can be clearly seen in the body of the report wherein it is stated that "the account (referring to the profit and loss account) should be drawn up in accordance with accepted accountancy principles consistently maintained . . . ". The recommendations of the committee provide for the inclusion in the act of a section devoted to the profit and loss account or income and expenditure account and in that proposed section is set out the minimum of information to be disclosed in those accounts, information which agrees in many particulars with the Dominion act.

In its opening words the proposed section goes a little

ahead of our act in that it provides specifically that if a material change is made in the basis on which the account or any item therein is calculated attention shall be called to the change and to the effect thereof by way of note on the account.

The section further provides that the aggregate, if material, of any amounts set aside to or withdrawn from reserves shall be disclosed and similarly that the aggregate of amounts set aside to or withdrawn from what have previously been referred to in these notes as reserves for contingencies shall be shown. This section, if enacted, will undoubtedly leave a great deal to the judgment of the directors and the auditors in deciding, firstly, what constitutes an amount set aside to a reserve and, secondly, what amount is material. But, in view of the committee's definite stand against undisclosed reserves and their recommendation that no reserve for diminution in value of assets shall exceed what is, in the opinion of the directors, reasonably required for the purpose, the case for hiding appropriations to reserves in the statement of income largely disappears.

Disclosure of directors' remuneration, which as the law now stands is similar to our 1934 act prior to the 1935 amendment, comes in for considerable revision. The committee recommends that the statement of income shall show separately or by way of note the following:

(a) Total emoluments, including contributions made on their behalf to any pension scheme, attaching to the office of director receivable by the directors from and as directors of the company, any subsidiary company or any other company of which the director is a director by virtue of the nomination of the first named company.

(b) The total of all other emoluments, including contributions made on their behalf to any pension scheme, receivable by the directors whether as directors or otherwise from such companies in connection with the management of their affairs.

(c) The aggregate amount of any compensation paid to directors or former directors for loss of office arising out of retirement from such companies.

(d) The aggregate amount of any pensions paid to directors or former directors by such companies.

Under subsection (b) above, it will be noted that dis-

closure is required of remuneration paid to managing directors, a feature which was introduced here when our act was amended in 1935.

In cases where the remuneration of the auditors is not fixed by the company in general meeting, it is recommended that the company be obliged to show such remuneration as a separate item in the profit and loss account.

Finally, as with the balance sheet, comparative figures for the preceding period are recommended as a compulsory feature.

Holding and Subsidiary Companies

Sec. 115 (Sec. 127). The committee recognizes the deficiency in the existing definition of a subsidiary and recommends a new definition aimed to include in the category of subsidiary company all companies of which the control is vested in the holding company.

Sec. 114. The report recommends that a holding company be compelled to prepare a consolidated balance sheet and consolidated statement of income drawn up as far as practicable in a manner similar to that recommended for the accounts of companies and that such consolidated accounts be presented annexed to the annual accounts. There is provision, however, that the Board of Trade may exempt banking, discount and assurance companies from consolidating with their accounts the accounts of any subsidiary carrying on a different business provided the relationship between the holding company and the subsidiary company is only temporary. It is also provided that if, in the opinion of the directors, it is impracticable or misleading to include in the consolidated accounts the accounts of any subsidiary company, the accounts of that subsidiary may be excluded; but in that case the directors must annex a statement giving the reasons why it is impracticable or misleading and stating:

(a) The holding company's share of the profit or loss as shown by the accounts made up for the period ending within the holding company's year.

(b) As far as practicable, the aggregate earned surplus since acquisition attributable to the holding company.

(c) Details of any qualifications in the auditor's report upon the accounts of the subsidiary.

If the accounts of any subsidiary consolidated with those

of the holding company are not made up to the same date as the balance sheet of the holding company the directors shall annex a statement giving the reasons why it is not practicable to do so.

The committee has seen fit to recommend the inclusion of a new section providing that profits or losses of a subsidiary prior to acquisition by the holding company shall not be brought into the accounts of the holding company as revenue profits or losses.

Audit

Sec. 119 (Sec. 133). As mentioned earlier in these notes substantial changes in persons eligible as auditors of limited companies are recommended. Verbatim the recommendations are as follows:

"None of the following persons shall be eligible for appointment as auditor of a company.

"(a) A person who is not a member of any body, membership of which has been designated by the Board of Trade as qualifying its members to audit the accounts of companies or who has not been designated by the Board of Trade as qualified to audit the accounts of companies;

"(b) A director or other officer or employee of the company or of any of its subsidiary companies or of a company which is a holding company in relation to the first-named company, or of any of the subsidiary companies of such holding company;

"(c) A person who is a partner of or in the employment of a director or other officer or employee of the company or of any of the companies referred to in sub-paragraph (b);

"(d) A body corporate."

Some indication of the professional bodies which the committee considers might be designated by the Board of Trade is given in the text of the report, where it is suggested that the list of "public auditors" appointed by the Treasury affords a precedent. This list, so far as future appointments are concerned, is limited to members of the various bodies of chartered accountants, of the Society of Incorporated Accountants and Auditors and of the Association of Certified and Corporate Accountants. The desirability of permitting accountants with adequate qualifications obtained outside Great Britain to audit companies' accounts is recognized in the provision giving the Board of Trade power to

designate persons who are not members of specified professional bodies.

Subsections (b) and (c) quoted above close up very considerably the loopholes in the present act, which has almost identically the same wording as our act. It is interesting to note that the exception extended in the present legislation to private companies has been omitted.

Sec. 118 (Sec. 132). The committee recommends the inclusion of a subsection that a retiring auditor if willing to act and eligible for appointment shall be deemed to be reappointed unless some other person is duly appointed in his place or a resolution that he shall not be reappointed is duly passed. If enacted this will presumably mean that the usual resolution re-appointing auditors at each annual general meeting will gradually disappear.

The committee considered that the present sec. 132(2) (Sec. 118(2) of the Dominion Act) should be amended to make it compulsory for the company to inform the Board of Trade in cases where no auditors are appointed. The latter body would then have the duty of appointing auditors for the current year.

Amendment of sec. 132(3) (Sec. 118(3) of the Dominion Act) is recommended so as to give a retiring auditor, to whom notice of intention to nominate another person has been sent, the right to send a written statement of his views to the shareholders at the reasonable expense of the company.

Sec. 120 (Sec. 134). Material amendment to this section is recommended with regard both to the auditors' report and to his right to attend meetings.

Dealing with the latter first, under existing legislation, both British and Canadian, the auditors have the right only to attend any general meeting of the company at which any accounts which have been examined or reported on by them are to be laid before the meeting. The suggested amendment gives to the auditors the right to receive notice of and attend any general meeting of the company.

With regard to the auditors' report the recommendation of the committee reads as follows:

"The auditors shall make a report to the members on the accounts examined by them and on every balance sheet and profit and loss account or income and expenditure

account, as the case may be, laid before the company in general meeting during their tenure of office, and the report shall state:

"(a) Whether in their opinion proper books of account have been kept or, in the case of a company with branches whose books have not been examined by the auditors, whether proper books of account have been kept at the principal office and branches visited by the auditors and proper accounts and returns adequate for the purposes of their audit have been received from other branches;

"(b) Whether or not they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit;

"(c) Whether the balance sheet and profit and loss account, or income and expenditure account, referred to in the report are in agreement with the books, accounts and returns, and whether in their opinion and to the best of their information and according to the explanations given to them the accounts are properly drawn up in accordance with the provisions of the new act and exhibit a true and fair view of (1) the state of the affairs of the company as at the date of the balance sheet and (2) the profit or loss, or net income or net expenditure, for the period ended on that date; and

"(d) In the case of a holding company which does not annex consolidated accounts to its annual accounts, whether in their opinion the reasons given by the directors for not presenting consolidated accounts are satisfactory and whether the particulars given in respect of profits or losses, or net income or net expenditure, and the qualifications in the auditors' reports upon the accounts of subsidiary companies have been properly compiled from the information contained in such accounts and the auditors' reports thereon."

In subsection (a) above the auditors are, in effect, called upon to report whether the company has complied with section 122 of the proposed new act. Subsection (b) shows little change from the wording of the present report. While it has been considered that the auditors' report would embrace the result of operations for the period as well as the balance sheet, the profit and loss account is not mentioned in the statutory requirements of the auditors' re-

port in either the British or the Dominion acts. The committee's recommendations in subsection (c) above rectify this situation. In the same subsection it is interesting to note that the wording "as shown by the books of the company" in the existing section has been altered so as to do away with any possibility which might have existed that auditors were within their rights in certifying that the accounts are properly drawn up simply because they are in accordance with the books. Under the British act auditors are not called upon to state in their report how the results of subsidiary companies have been dealt with and it is the responsibility of the directors to make a statement along the lines of our section 114. The proposed amendments still place on the directors the responsibility for such a statement but under subsection (d) above the auditors are called upon to state their opinion of the directors' statement.

In the case of a holding company annexing consolidated accounts to its annual accounts, the committee recommends that the auditors be required to examine the consolidated balance sheet and consolidated profit and loss account and to make a report to the members of the holding company stating whether in the opinion of the auditors:

(a) The consolidated balance sheet and the consolidated profit and loss, or income and expenditure, account are properly drawn up in accordance with the provisions of the new act from the balance sheets and profit and loss, or income and expenditure, accounts of the holding company and of the subsidiary companies, the accounts of which have been consolidated, after giving effect to any adjustments made by the directors.

(b) The adjustments, if any, made by the directors are appropriate, or any other adjustments are required, according to the best of their information and the explanations given to them by the directors of the holding company.

(c) The reasons given by the directors for the impracticability of making up the balance sheet of any subsidiary company to the same date as that of the holding company are satisfactory.

(d) The reason given by the directors for excluding any subsidiary company from consolidation are satisfactory.

(e) The particulars given in respect of the profits or losses, or net income or net expenditure, and the qualifica-

tions in the auditors' reports upon the accounts of subsidiary companies excluded from consolidation, have been properly compiled from the information contained in such accounts and the auditors' reports thereon.

The committee also recommends that the auditors be required to refer in this report to any qualification upon the accounts of the holding and subsidiary companies which have been consolidated, provided that it shall not be necessary to refer to any qualification which, whilst applicable to the accounts of a subsidiary company as a separate company, is not material in relation to the consolidated accounts.

Although it cannot be denied that the recommended amendments would make of the auditors' report a much more formidable article, it is surely fair to say that the additional onus which the new report would put on the auditor would lie more in its additional length than in its additional responsibilities. Is it not largely a matter of the auditor in his report being obliged by statute to answer questions which sound accounting practice and auditing procedure compel him to ask himself and to report on if the answers he obtains are not satisfactory?

Some Aspects of Company Law Reform

By W. Kaspar Fraser, K.C.
Toronto, Ontario

THE committee appointed by the president of the Board of Trade to consider amendments to the English Companies Act has recently issued its report, after extended hearings, at which evidence was submitted by numerous organizations and individuals.

The committee was satisfied by the evidence that, in general, companies are honestly managed; and emphasized the importance of not imposing unreasonable restrictions upon business which is properly conducted. The recommendations recognize the importance of disclosure as a means of lessening opportunities for abuse and the desirability of facilitating the exercise by shareholders of more effective control over the management.

Among the aspects of company law dealt with which are of major interest and importance to those having to do with

the financing and administration of Canadian companies are the following: prospectuses; financial relations between companies and their directors; shareholders' control; arrangements and amalgamations. Important also are the recommendations in respect of the form, contents and circulation of accounts and the qualifications and duties of auditors; the latter recommendations are more appropriate for comment by members of the accounting profession.

Prospectuses

Traditionally, the primary function of the prospectus is to state to the investor the facts, with particular emphasis on the merits, in relation to the security which the investor is being induced to acquire. This function tends to become obscured by the necessity for complying with legal requirements imposed with a view to ensuring that the prospectus discloses all material facts. If these requirements are sufficiently stringent the result is a document of inordinate length and complexity, unlikely to be read and difficult to be understood by the individual investor. An example is the typical prospectus complying with the U.S. Securities Act. Under such circumstances the function of the prospectus, apart from meeting the requirements of some regulatory commission for permission to offer the security, is to achieve full technical compliance in respect of disclosure. Indirectly, to the extent that such compliance is defective, the prospectus facilitates the enforcement of claims against directors or other persons responsible for the prospectus if later things go wrong.

The recommendations of the committee in respect of additional disclosure indicate an intention to preserve the primary function of the prospectus and to avoid undue length and complexity.

The following is a summary of the principal new requirements for disclosure.

Particulars are to be given in respect of any shares or debentures which are or are agreed to be optioned. Similar requirements are imposed by s. 77(1)(e) of the Dominion act and s. 49(1) of the Ontario Securities Act, 1945.

In order to disclose the margin between the price at which property was originally acquired by intervening vendors and the price paid by the company, particulars are to be given of transactions, within two years of the date of

issue of the prospectus, in which any vendor, director, proposed director or promoter was or is interested, directly or indirectly. It will still remain unnecessary to disclose transactions where none of the classes of persons indicated were interested.

The persons by whom preliminary expenses are payable are to be indicated; to be shown are the amount or estimated amount of the expenses of the issue, so far as not included in the statement of preliminary expenses, and the persons by whom such expenses are payable. These would include the cost of advertising the prospectus, which under the English system of public offering is a substantial item. Under the Canadian procedure of underwriting advertising, expense is normally not important, particularly in the case of issues by Dominion companies where the scope of the advertisement which may be issued, without bringing it within the definition of a prospectus, is severely restricted.

Any benefit, in addition to any payment, given or intended to be given to any promoter and the consideration are to be shown.

The committee concluded against recommending that a summary of material contracts should be given, on the ground that this would result in the giving of such detail that the prospectus would be unduly lengthened without conveying clear information to the ordinary investor. The general nature of each material contract is to be given; this requirement is similar to that imposed by s. 77(1) (s) of the Dominion act. Copies of material contracts referred to in the prospectus are to be filed with the registrar. The committee points out that, if its recommendation for prescribing a period (not less than two days, excluding Saturdays, Sundays and bank holidays) between the advertising or first issue of the prospectus and the opening of the lists is adopted, there will be a brief opportunity for inspection; and that the contracts will be available for future reference. It has not been found in this country that requirements for filing of documents in a public office afford protection to intending investors of which they avail themselves.

A further requirement, aimed at the omission of any material information, is that there should be stated "all other facts known, or which could on reasonable enquiry

have been known, to the directors, the omission of which would make any statement in the prospectus misleading". It may well be that the legal advisers of the company, in their endeavours to protect directors (and others liable for statements in the prospectus) against the consequence of an omission, which in the light of after events may be held to be material, will recommend the inclusion of additional information in sufficient detail substantially to lengthen the prospectus.

With respect to the financial information to be disclosed in the prospectus, there is to be a statutory obligation that the prospectus is to contain a report by the auditors of the company with respect to its assets and liabilities and, in addition, in the case of an issue by a holding company, as defined, a like report with respect to the assets and liabilities of the company and its subsidiaries; in making such reports the auditors are to make such adjustments as are in their opinion necessary for the purposes of the prospectus. Under both the Dominion act and the Ontario Securities Act, 1945, where a consolidated balance sheet is required, this is in substitution for the legal balance sheet. There is no recommendation requiring the balance sheet to be made up to a date falling within a specified recent period. This is a requirement under the Dominion act (s. 77(3)(a)(i)) and the Ontario Securities Act, 1945 (s. 49(5)). No requirement is proposed in respect of furnishing a pro forma balance sheet. While in Canada also this is not a legal requirement, under certain circumstances, underwriters require and accountants recommend as necessary for the information of the investor the inclusion of a pro forma balance sheet giving effect to the financing and the carrying out of transactions specified in the prospectus, if these are important.

The period, which the report on profits or losses year by year is to cover, is extended to five years or from the date of incorporation, whichever is longer; and, if no accounts have been made up for a period ending on a date three months preceding the issue of the prospectus, this is to be stated. In the case of a holding company, as defined, consolidated earnings only are to be reported on. In making the report on earnings the auditors are to make such adjustments (if any) as are in their opinion necessary for the purposes of the prospectus.

While the period to be covered by the earnings report under the Dominion act is only three years, in practice, underwriters insist on the report covering a much longer period and require the earnings of one or more pre-war years to be shown, if available. The committee points out that the auditors would not be justified in withholding comment, if, for any reason, the period covered by the report was affected by exceptional circumstances, of which war or trade cycles are mentioned as examples.

The reports on assets and liabilities and on earnings are to show the figures as adjusted by the auditors. A statement showing such adjustment is to be filed with the registrar. Under the Dominion act the actual balance sheet must be included and the better opinion is that actual earnings must be shown. Where adjustments are required to give a true picture of the earnings year by year available to service the interest or dividend requirements of the securities or shares offered, in Canada, auditors customarily specify the adjustments in the report or at least indicate the result of making requisite adjustments.

The rates of dividends paid on each class of shares for five years or shorter period, as the case may be, are to be shown. While there is no similar requirement under the Dominion act, if shares are offered, the dividend record, if relevant, is summarized in the prospectus.

Additional reports of accountants to be named in the prospectus are to be required in respect of the assets and liabilities and the results of a business to be purchased or of a company shares of which are to be purchased, and which by reason of such purchase is or will become a subsidiary as defined. These requirements only apply if the proceeds, in whole or in part, are to be applied directly or indirectly in such purchase. The report (or reports where the issuer is a holding company) on assets and liabilities is to be similar to the report required in the ordinary case above outlined. The report with respect to profits or losses of the business to be acquired, or with respect to the results of the company which is, or is to become, a subsidiary (the report in the latter case to be in respect of the profits or losses attributable to the share interests acquired or being acquired) is to cover each of the five financial years immediately preceding the issue of the prospectus (or shorter

period since commencement of the business of the new subsidiary) ; and, if no accounts have been made up for a period ending on a date three months before the issue of the prospectus, this is to be stated. The figures to be shown are to be adjusted if necessary in the opinion of the accountants. Provisions similar to those above outlined are to apply where the issuer is a holding company as defined.

The provisions above outlined are more far reaching than those contained in the Dominion act (s. 77(3)(c)).

No recommendations are made in respect of requiring the statutory information to be set out in type at least as large as that used in the body of the prospectus. This is a requirement under the Dominion act (s. 77(2)).

As regards civil liability for statements in the prospectus, this is to be extended to misleading as well as untrue statements. In respect of liability of directors, promoters and others for a mis-statement, purporting to be a statement by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it has heretofore been a sufficient defence if it is proved that it fairly represented the statement or was a correct and fair copy of an extract from the report or valuation, unless it is shown that the person sought to be made liable had no reasonable ground to believe that the person making the statement, report or valuation was competent to make it. This is also the situation under s. 78(1)(iv) of the Dominion Act. The recommendation of the Committee is that the onus is to be shifted, so that the defendant, in order to escape liability, must prove affirmatively that he had reasonable cause to rely on the expert making the statement, report or valuation. There is to be included in the list of persons liable for untrue or misleading statements every expert. who consents in writing to the inclusion in the prospectus of any copy of or extract from or summary of his report in the form and context in which it appears. The written consent of any expert, as defined, to such inclusion of any copy of or extract from or summary of his report is to be delivered to the Registrar with every prospectus, which is not an offer to existing holders of shares or debentures. An expert is only to be liable for an untrue or misleading statement included in the prospectus with his written consent, but is not to be liable if he

proves that he had reasonable ground to believe and, up to the time of allotment, did believe that the statement was true and not misleading, or if he proves that, upon becoming aware of the fact that the statement was untrue or misleading, he notified the directors and withdrew his consent.

The expression "expert" as defined in s. 27 of the Companies Act, 1929, includes engineer, valuer, accountant and any other person whose profession gives authority to a statement made by him. The definition in s. 78 of the Dominion act is the same. Obviously, a solicitor would be included. If any copy of or extract from or summary of the report of the expert appears in the prospectus with his written consent (which consent is required to be delivered to the registrar for registration with the prospectus) liability for untrue or misleading statements in the report will attach to the extent above indicated.

During the hearings evidence was submitted that bankers, brokers, solicitors and auditors should be subjected to the same liability as attaches to directors and promoters for misstatements in the prospectus. The committee concluded that it would not be justifiable to extend such liability to banks and professional men by reason only of the fact of their appointment being stated in the prospectus. Under the English system of effecting public issues the name of the bank is displayed in prominent type on the face of the prospectus. The function of the bank is to receive subscriptions and application moneys. Under the Canadian system (with the exception of the rare case where the company solicits direct subscriptions without the intervention of underwriters) it is the function of the issuing house to receive applications from purchasers of securities which the issuing house itself has agreed to take up and which it resells to the public. Moreover, chartered banks are precluded under the provisions of the Bank Act from allowing their names to appear on a prospectus.

Financial Relations Between Companies and Directors

The evidence submitted to the committee mainly dealt with transactions by directors in the shares of companies of which they are directors, disclosure of remuneration, compensation for loss of office upon an amalgamation, loans to directors and voting by directors on matters in which they are interested. The evidence did not indicate that im-

proper share transactions by directors were common. The committee concluded that the remedy for any evil which may exist lay in requiring publicity and pointed out that the practice in the United States of requiring directors' transactions to be disclosed did not appear to have had any bad result. The recommendations involve (a) immediate disclosure to the board; (b) making such disclosure available to shareholders once a year, and (c) the imposition of a fine both on the director and the company for non-compliance with their respective obligations.

A director is to declare in writing, at a meeting of the board, his interest direct or indirect in any shares or debentures of the company or of any subsidiary or of any company of which the company itself is a subsidiary. The declaration is to be made on the coming into force of the new act or on the acquisition of the interest, whichever is later. Notice of sale or termination of the interest is to be given in writing at the next meeting of the board following.

Such interests, sales and purchases (with dates and prices received or paid) are to be recorded in a book kept specially for the purpose. The book is to be open for inspection at the registered office by any member or debenture holder for fourteen days before the annual meeting; copies may be taken; and the book is to be laid on the table at the annual meeting. The holding or dealing in shares or debentures by or on behalf of a company in which a director has an interest, which must be a controlling interest, will be covered; similarly options to acquire, sell or dispose of shares or debentures will be deemed to be an interest in such shares or debentures.

Knowledge by the director of his interest and failure to comply with the obligations imposed are to subject him to a fine; and failure by the company to comply with the requirements imposed on it with respect to the book in which directors' transactions are to be recorded is to subject it to a fine.

It has not been found that shareholders frequently avail themselves of the information to be made available to them at the annual meeting of the annual statement of transactions in shares or securities by directors of public companies, pursuant to s. 96A(1) of the Dominion act. That

section also prohibits, under penalty, speculation for his personal account, directly or indirectly, by a director of a public company in the shares or securities of the company of which he is a director.

The committee found that the existing provisions for disclosure to shareholders of the remuneration of directors did not go far enough. Such provisions exclude the operation of the requirement as to disclosure in relation to a managing director or any sums paid otherwise than as directors' fees to any director holding any salaried employment or office. While a further provision entitles shareholders, entitled to twenty-five per cent of the voting power, to require disclosure of the aggregate remuneration of all directors, including the managing director, such right is liable to be defeated by a proviso negativing the right to such additional information if the shareholders pass a resolution that the information be not furnished. Under the Dominion act (s. 113(2)) there must be shown the total amount paid as salaries, bonuses, fees or other remuneration to the counsel, solicitors, or other legal advisers, and executive officers, including the managing director, and any other director, who holds any salaried employment or office in the company and devotes substantially the whole of his time to the business of the company or its subsidiaries. The committee did not consider that the principle of disclosure should apply to executives who are not directors. In the result, the recommendations involve disclosure of the total emoluments attaching to the office of a director as such and receivable by the directors as directors of the company, any subsidiary, or any other company in which the director holds office by virture of a nomination by the company; disclosure of all other emoluments receivable by directors in that capacity or otherwise from such companies in connection with the management of their affairs; disclosure of expense allowances to the extent treated as income of the director for income tax purposes.

Amendments are recommended designed to make directors accountable for amounts received as compensation for loss of office, or in connection with retirement, or benefits receivable (in excess of those attributable to their shareholdings) upon an acquisition of the assets or of shares (on a general offer for the acquisition of shares) of

another company, without disclosure to and approval by the shareholders.

Loans to directors by a company or a subsidiary are to be prohibited, except in the case of a loan made in the ordinary course of business by a company, the ordinary business of which includes the lending of money. A similar provision, in respect of loans by a company, which also extends to shareholders, appears in s. 15(1) of the Dominion act.

Suggestions were made to the committee that there should be a general prohibition against directors voting at board meetings on contracts in which they are interested. The committee, while noting that the London Stock Exchange, as a condition to permission to deal, requires the insertion in the articles of a provision prohibiting voting except on limited classes of contracts, considered a general prohibition to be impracticable. The recommendation in this regard is limited to a requirement that, where notice of the interest of the director is given to the board as required under the existing law, it is to be noted at the meeting of directors next following receipt. In addition the committee suggests that directors, as a general rule, should disclose in the report to shareholders contracts of any magnitude in which any director has a substantial interest. In this connection, it may be noted that the Dominion act (s. 95) prohibits voting by a director who is interested, except in the case of a contract to give security for advances or by way of indemnity, in the case of a private company where there is no disinterested quorum, in the case of a contract between the company and another company (usually a subsidiary) where the director's interest is limited to his being an officer or director and holding his qualifying shares. In other cases, where it is not possible to have the directors authorize the contract, by reason of the absence of a disinterested quorum, it is necessary, under the Dominion act that the contract should be confirmed at a special general meeting of the shareholders.

Shareholders' Control

The ultimate control over the administration of the affairs of a company rests with the shareholders. Such control is exercisable by voting in person or by proxy at meetings; and in practice is limited mainly to the election

of directors, criticism, in case of dissatisfaction, on matters affecting general policy or administration, or refusal to authorize or sanction proceedings or transactions initiated by the directors and requiring approval by the shareholders.

Individual shareholders, as a rule, show little interest in meetings; rarely attend annual meetings and do not attend special general meetings in any numbers unless the proposal to be submitted is highly controversial. In the ordinary course, proxy forms, sent out by the management with the notice of meeting and containing the names of officers as proxies, are signed and returned. In the result, the directors having the control of the machinery for the summoning and conduct of meetings, proceedings at annual meetings tend to be purely formal; the accounts are approved, the existing board is re-elected and the auditors are re-appointed, without discussion or opposition.

In Canada, there has been consistent improvement over the last ten years, particularly in the case of large public companies, in the accounts submitted to the shareholders at annual meetings. The directors' report, which customarily accompanies the copy of the accounts and the notice of the annual meeting, reviews the operations of the company over the past year. As a general rule, in the case of well managed companies of any size the accounts and directors' report are sufficiently informative to make it unnecessary for shareholders to attend the annual meeting for the mere purpose of keeping in touch with the activities of the company. The committee points out that in England the formal directors' report required by law to be attached to the balance sheet is quite uninformative. While commending the practice of sending with the accounts a print of the speech which the chairman proposes to make at the meeting, and stating that the directors' report ought to contain a review of the company's activities and be as informative as possible, the committee considers that no extension of the existing requirements as to the directors' report is possible.

The recommendations of the committee in respect of meetings are mainly designed to enable shareholders to interpose effective opposition where proposals, which may be open to objection, are submitted; to give shareholders more time to consider proposals to be submitted at meetings; to enable them to organize effective opposition to proposals

which may be open to objection; and generally to encourage and facilitate an expression of their views.

No less than 21 days' notice is to be required, in the case of annual general meetings, and not less than 14 days' notice in the case of other meetings (subject to the requirement of 21 days' notice applicable in the case of a meeting called for the passing of a special resolution). A majority in number holding 95 per cent of the voting share capital is to have the right to accept shorter notice, where 14 days' notice is required. In the case of an annual general meeting the unanimous consent of all the shareholders entitled to attend and vote is to be requisite for less than 21 days' notice.

The requirement of the Dominion Companies Act (s. 117) applicable to public companies, that copies of the accounts to be submitted at an annual meeting are to be mailed to shareholders not less than 14 days before the meeting, in practice results in 14 clear days' notice of annual meeting being given, as it is customary to mail the accounts with the notice of meeting. The statutory requirement of 14 clear days' notice of meetings is only operative in the absence of other provisions in the letters patent, supplementary letters patent or by-laws (s. 99).

The recommendations in respect of meetings include the following: every member entitled to vote is to have the right to vote by proxy on a poll; the time limit for lodging instruments of proxy is not to exceed at least 48 hours before the time for holding the meeting or adjourned meeting; a shareholder is to have the right to appoint as proxy any person, whether a shareholder or not, and the notice of meeting must draw attention to such right; a proxy is to have the right to speak, as well as to vote; if at the expense of the company, forms of proxy or other communications inviting the appointment of named persons as proxies are sent by the directors or other officers to shareholders, such forms or other communications must be sent to all shareholders; a shareholder is to be entitled to cast or direct a proxy to cast some of his votes against and others for a resolution or to abstain as regards other resolution, i.e., statutory recognition is given to the right, as to which question has arisen, to split the votes in respect of a shareholding, particularly in the case of shares held by nominees

for various beneficial interests; a poll may be demanded on any question other than an adjournment; a proxy to have the same right as a shareholder to demand a poll; five shareholders or the holders of not less than 10 per cent of the paid-up share capital or of the total voting rights of all the shareholders entitled to vote at the meeting, are to have the right to demand a poll.

On the vexed question of the two-way proxy the committee refrained from making any specific recommendations. The term two-way proxy is a misnomer. It is a form of instrument, which has been developed in connection with compromises and arrangements, under which the shareholder instructs the proxy to vote in favour of or against the scheme for the consideration of which the meeting to which the instrument of proxy relates is being held. In effect, the use of such an instrument amounts to the casting of a vote in advance of discussion at the meeting, by reason of the instructions contained in the instrument. While the committee conceded that there were advantages in the use of the two-way proxy, to the extent that thereby shareholders' control would be facilitated, it considered impracticable the compulsory adoption of the procedure, or the suggested alternative procedure of the three-way proxy. The latter is a form of instrument under which the proxy is directed to vote for or against certain specified resolutions and is authorized to vote at his discretion in respect of the resolutions or matters not specified. An enlightening discussion of the difficulties inherent in the use of the three-way proxy will be found at pages 759 and 760 of the minutes of evidence.

In Ontario the two-way proxy, which used formely to be used for meetings to consider a compromise or arrangement, has latterly been generally abandoned. It has been found to be a preferable procedure to issue two forms of instrument of proxy in the usual form, one containing the names of officers who will vote in favour of the proposals, unless otherwise instructed, the other leaving a blank for the insertion of the name of the proxy whom the shareholder may desire to appoint.

With respect to the election of directors, unless the meeting unanimously determines otherwise, a separate resolution is to be required for the election of each director; and

any director (subject to an exception in the case of a permanent director of a private company) is to be subject to removal by ordinary resolution of the company, without prejudice to any contractual right to damages, where there is a contract relating to his services.

A wholly novel recommendation of the committee is designed to enable shareholders, subject to certain safeguards, to require the company to circulate certain communications to shareholders. There is to be the right on the part of 100 shareholders holding on the average not less than £100 of the paid-up capital per shareholder, or a shareholder or shareholders entitled to not less than 5% of the votes exercisable at a general meeting (a) on not less than 35 days' notice before an annual general meeting, to require the company to send out with the notice of the meeting a copy of any resolution which they propose to introduce, with a supporting statement not exceeding 1,000 words; any such resolution to be deemed to be within the scope of the meeting; (b) to require the company to send to shareholders entitled to receive notice of a general meeting, a copy of a communication not exceeding 1,000 words relating to any matter to come before a general meeting, provided that the communication is delivered to the company not more than 7 days after the service of the notice convening the meeting.

In both cases the reasonable expenses of making copies of the resolution or communication to be sent to shareholders must be tendered to the company, subject to refund if the company in general meeting so resolves.

Arrangements and Amalgamations

It was pointed out to the committee in evidence that the sanction of the court to an arrangement can be obtained under the existing procedure without information being furnished, as to whether the requisite class vote has been obtained only by the votes of members of one class of shareholders having a preponderant interest as members of another class of shareholders or as creditors; or as to the personal interests of directors or trustees for debenture holders recommending the arrangement.

As a matter of law a shareholder is not precluded from voting as a member of one class by reason of his holding shares of another class affected by the arrangement.

As to the question of the make-up of the vote sanctioning an arrangement, the committee pointed out that, having regard to the practice of registration of shareholdings in the names of nominees, full information may not be obtainable, although the best information available should be before the court. The committee concluded that the point involved is one of procedure and not appropriate for legislation.

In all cases a circular explaining the arrangement is to be issued with the notice convening the meeting. It is customary in Canada to issue such a circular, not only for the purpose of summarizing the effect of the arrangement in non-technical language, but also for the purpose of drawing the attention of shareholders to the necessity for and the advantages of the arrangement. The circular is to state any material interest of the directors in the arrangement; if debentures are affected by the arrangement, any material interest of the trustee (if any) for the debenture holders is similarly to be disclosed in the circular; in the event of default, every director or trustee for debenture holders knowingly a party to the default is to be subject to a fine. While what constitutes a material interest is not defined, no doubt, as in the case of the requirement to disclose material contracts in the prospectus, little practical difficulty will be encountered in determining whether any particular interest should be disclosed. Obviously, the requirement would involve a statement of the shareholdings direct or indirect of a director and members of his family in each class of shares affected by the arrangement.

A convenient method of amalgamation is provided by the statutory right of acquiring the outstanding minority interest, where a scheme or contract for the acquisition by one company of shares of another company has been approved by the requisite precentage of holders of the shares affected. Section 124 of the Dominion act substantially adopts the corresponding provisions of the Companies Act, 1929, in this regard, which provides means (subject to an order of the court) for the acquisition of a minority interest on the terms on which the other shares were acquired, if the contract of scheme has been approved by the holders of 90 per cent of the shares affected. In this country such a scheme is customarily carried out by means of an offer to

exchange shares of the purchase company for the shares to be acquired, although sometimes the offer is to purchase such shares for cash. Ordinarily, in Canada, the terms of a proposed exchange offer will be canvassed with the principal shareholders and individual directors; and, if approved by them, the offer will be accompanied by a circular recommending its acceptance by the shareholders to whom the offer is made. If the purchaser company is in a position to do so, it will require the issuance of such a circular, which is considered to be important, if not essential, for the purpose of inducing acceptance of the proposal. Where a circular recommending an exchange offer is issued, there is an argument that there should be a statutory requirement that the reasons for recommending acceptance should be disclosed and that the circular should be accompanied by a recent financial statement, not necessarily audited. The offer may be made at a date some time after the last financial statements have been made available to the shareholders and, in the meantime, important developments may have occurred affecting the value of their shares. Under existing statutory provisions a minority shareholder has no redress by reason only of the fact that there was not made available to him full information to enable him to determine whether he should accept or reject the offer. His obligation is to establish affirmatively that the price offered is inadequate.

The committee draws attention to two defects in the existing statutory provisions: first, the absence of any provision where the purchaser already holds more than 10 per cent of the shares or class of shares proposed to be acquired; and, secondly, the fact that the dissenting minority has no right to compel the purchaser company to acquire its shares.

On the first point the recommendation is that the statutory provisions should apply, notwithstanding that the transferee company is already the holder of one-tenth or more of the shares affected, provided that the scheme or contract entitles all holders (other than the transferee company) to sell their shares on the same terms and that there has been approval by the holders of not less than 75 per cent in number, holding between them not less than nine-tenths in value, of the shares or class of shares sought to be acquired.

The recommendation on the second point is that where, as a result of the scheme or contract, the transferee company has become the holder of not less than nine-tenths in value of the shares (or of any class of shares) of the other company, it is to be the duty of the transferee company to notify the fact to all holders of shares (or of any class of shares) in such other company; every such holder is to be entitled, within three months of such notification, to require the transferee company to acquire his shares at a value to be agreed, or in default of agreement to be settled by the court. It is apparently contemplated that in default of agreement the value to be determined by the court would be payable in cash.

INSTITUTE OF INTERNAL AUDITORS

Beginning Tuesday, January 8, 1946, the Extension Department of the University of Toronto will offer a series of ten evening lectures in internal auditing. The course is sponsored by the Toronto chapter of the Institute of Internal Auditors, who will supply the lecturers.

Measures of Central Tendency in Accounting

By William McL. Hamilton, B.Sc.(Comm.)
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THE mechanics of bookkeeping serve to collect all the individual items of a given nature in one account, so that they can be expressed in a single total in whatever statement is prepared from the books of account. It is often necessary, however, to go behind one or more of the items in such a statement to obtain additional information, which may not be available even by analysis of the ledger account itself, but resides in the mass of data from which the book of original entry was compiled. In work of this kind, useful assistance can be obtained, and a more satisfactory analysis made, through the use of certain methods which have been developed by statisticians for the analysis of the masses of data with which they work.

Averages—which are correctly termed "measures of central tendency"—are particularly deserving of more attention than they usually receive. Proper analysis of such items as wages, profits, sales, invested capital and many other accounts appearing in the annual statement can reveal most interesting information. Equally important, as a subsequent example will show, is the use of alternative methods in cases where one method yields an unrepresentative figure.

There are three principal measures which denote the central tendency of a given group of figures; the arithmetic mean, the median, and the mode. While each of the foregoing may be easily ascertained from a small group of data, calculations involving more than thirty to forty items tend to become involved, and a special technique, the frequency distribution, has been developed for the handling of large groups of figures. In this paper, we shall deal first with each of the measures of central tendency as applied to a small group of data, and then show in what manner the frequency distribution can assist in classifying and handling large masses of data.

For purposes of illustration, use will be made of the following data, which was abstracted from a table of hourly rates for certain occupations in the primary cotton industry in 1934. In the following listing there seems to be no order to the amounts, and it is obvious that generalizations concerning the data would be difficult to make, and subject to considerable error, were they made simply by inspection.

TABLE "A"

Wage rates for selected occupations, primary cotton industry, 1934.

.2655	.2242	.2443
.2234	.2083	.2614
.2844	.2807	.2989
.4438	.4136	.4705
.2801	.2884	.2581
.2583	.5866	.9600
.6126		.6808

The Arithmetic Mean

The arithmetic mean is the average which is familiar to almost everyone, as is its method of calculation, which is to add together all the items and divide the result by the number of items. In our particular example, the sum of the twenty items is $7.5439, and their average is

$$\frac{7.5439}{20} \text{ or } .3772.$$

Because the arithmetic mean is easily computed, easily understood, commonly used and generally recognized, its advantages are obvious, and have given it considerable prominence. It has one disadvantage, which is that a few extreme numbers in a group distort it unduly. For example, in the series with which we are now dealing, the four highest amounts are considerably in excess of any of the other items (see the arrangement in table B, which follows), and if we drop these four amounts and compute an average of the remaining sixteen items we find it to be .2940, which a cursory inspection indicates is a more representative figure for the entire group than our original calculation of .3772.

The Median

This shortcoming does not affect either the median or the mode, which is one of their major advantages, for they are what is known as averages of position. To ascertain them, it is necessary that the data in question be assembled in order of magnitude. Thus, the data which we are using for an example can be compiled into the accompanying table.

TABLE "B"

Wage rates for selected occupations, primary cotton industry, 1934.

.2083	
.2234	
.2242	
.2443	
.2581	
.2583	
.2614	.2614 (Mode)
.2655	
.2801	
.2807	.2825 (Median)
.2844	
.2884	
.2989	.3772 (Mean)
.4136	
.4438	
.4705	
.5866	
.6126	
.6808	
.9600	

The median is the value which divides such a table into equal parts; that is, when the items are arranged according to size, the median is the middle item. When there is an even number of items, so that no single item divides the group into exactly equal parts, the median is taken as the

arithmetic mean of the two central items. Thus, in our example, which contains twenty items, the median is

$$\frac{\text{10th item} + \text{11th item}}{2} \text{ or } \frac{.2807 + .2844}{2} = .2825$$

Had there been 21 items we would have used the eleventh item intact, since that would have divided the table into a group of ten preceding the median and a group of ten following it.

The Mode

The mode of a group of values is the value around which the items tend to be most heavily concentrated, that is the most frequent or most typical of the values. Strictly speaking, the mode should be repeated—as in the series 2, 4, 5, 7, 7, 7, 9, 10, where the mode is obviously 7. In our example, however, no item is repeated exactly, and hence no proper mode exists; however, the close grouping of the items from .2581 to .2655, where there are four items, suggests that an item in that vicinity could be chosen as a representative mode; .2614, which is close to the centre of the group, seems the logical choice. It will be noted that the mode always, and the median at certain times, are actual numbers from the data being surveyed.

The advantages of both the median and the mode as a measure of central tendency are that they are easily calculated, not distorted by unusually large or small items and hence more typical of the larger number of items in the series. Against this must be laid their disadvantages, which are that they are not so generally familiar as the mean, and that the data must be arranged according to size before they can be computed.

Illustration in Use

In table B we have indicated the three measures of central tendency in their respective places, and the differences between them are interesting to note. The mean has been considerably distorted by the few unusually large items, and any conclusion based upon it as typical of the entire series would almost certainly be erroneous. There are, for example, almost twice as many items (13) below this item as there are above it (7), while the nearest actual rates to it are .2989 below and .4136 above, so that the figure arrived at for the mean is considerably removed from any actual amount in the table itself. The median and the

mode, however, are very representative of the data, although in this instance the median is preferable, since it was subject to calculation while the mode was not as clearly defined as it might have been had some of the items been repeated.

On the basis of such an analysis it is possible to say without fear of contradiction that the average rate of wages, per hour, for these selected occupations in the primary cotton industry in 1934 was .2825 cents (median) and that a typical wage was .2614 cents (mode). Anyone using the generally accepted "average" and quoting .3772 cents as an average wage rate would obviously be quite wrong if he considered his average as typical in any way of the rates being paid.

Classification Into Groups

Unlike the sample example we have used so far, which contains only twenty items, actual practice often entails the analysis of numerous items, running into the hundreds, and in such cases it is manifestly impossible to deal with individual items with any degree of efficiency. In such cases the frequency distribution offers a solution, since it classifies the data into manageable groups. The following table is a frequency distribution of 105 items, yet it is considerably more easy to appreciate than the series of 20 items we used previously.

FREQUENCY DISTRIBUTION OF INVESTMENT YIELDS, COMMON AND PREFERRED STOCKS, JUNE 7th, 1945.

(Source: *Financial Times*, June 8th, 1945)

Yield %	*No. Stocks*
1.50—1.99	1
2.00—2.49	1
2.50—2.99	2
3.00—3.49	6
3.50—3.99	17
4.00—4.49	20
4.50—4.99	18
5.00—5.49	17
5.50—5.99	7
6.00—6.49	5
6.50—6.99	7
7.00—7.49	4

In the preparation of a table such as the foregoing, certain procedures should be adopted for consistent results. The classes, for instance, into which the table is divided should not merge into one another, for if they do uncertainty arises as to the location of border-line items.

Thus, if the first two classes in our tabulation had been 1.50 - 2.00 and 2.00 - 2.50 an item of 2.00 could legitimately be placed in either class.

Frequency Distribution

Most mathematical manipulations of a frequency distribution postulate that the data is distributed evenly throughout each class, and wherever possible the class limits should be chosen so as to give effect to this, and so that any concentration of data falls about the centre of the class. Thus, if we are dealing with meal checks of a cafeteria, many of which are multiples of five cents, the appropriate intervals might be .08 - .12, .13 - .17 and so on, so that the mid-values of 10 cents, 15 cents, etc., would coincide with the points of concentration of the data. Again, the class interval may be varied to accommodate certain data which extends over a wide field but tends to concentrate at a certain point. Thus, we might start with class intervals of $10.00, reduce to $5.00, $2.50, and even lower as the concentration increases, and then widen the interval again as the data becomes more discrete (broken). Finally, there is the method of open-end distribution, in which the first class is "$xx and under" and which continues through the requisite number of regular classes, with the last class "$yy and over".

The number of classes depends upon the amount of data available, and its even distribution or otherwise. Fewer than seven classes or more than sixteen are seldom found. In general, classes should be so chosen, both in number and class intervals, that the data is fairly evenly distributed, without too-apparent irregularities, in increasing and subsequently decreasing numbers, much as in the example we have used.

Details of Calculation

Obtaining measures of central tendency from data arranged in a frequency distribution is only a little more difficult than from a similar number of individual items. The calculations are usually based upon the simple axiom, already mentioned, that the items within each class are evenly distributed throughout it. Thus, in calculating the arithmetic mean, the mid-point of each class is taken as representative of all the items therein, and multiplied by their number to obtain a sum representative of them all. These sums are then added, and divided by the total number of

items to obtain a mean. The following example, using the stock yield data already quoted illustrates the procedure.

CALCULATION OF ARITHMETIC MEAN, FREQUENCY DISTRIBUTION OF COMMON AND PREFERRED STOCKS

Yield %	*Frequency* (*f*)	*Mid-Point* (*m*)	*f x m*
1.5—1.99	1	1.75	1.75
2.0—2.49	1	2.25	2.25
2.5—2.99	2	2.75	5.50
3.0—3.49	6	3.25	19.50
3.5—3.99	17	3.75	63.75
4.0—4.49	20	4.25	85.00
4.5—4.99	18	4.75	85.50
5.0—5.49	17	5.25	89.25
5.5—5.99	7	5.75	40.25
6.0—6.49	5	6.25	31.25
6.5—6.99	7	6.75	47.25
7.0—7.49	4	7.25	29.00
	105		500.25

$$\text{Arithmetic Mean} = \frac{500.25}{105} = 4.764\%$$

The only point not perfectly clear in the foregoing table is the amount selected for the mid-point of each class; this is obtained by finding the arithmetic mean of the lower limits of two adjacent classes. For example, 1.75, the first mid-point, is

$$\frac{1.5 + 2.0}{2} = 1.75$$

Calculation of Median and Mode

The calculation of the median in a frequency distribution is even simpler than the foregoing, since it consists merely of locating the class containing the median and interpolating within that class. Thus, for 105 items, the median is the 53rd item; accumulating the totals as we go along, we find that there are 47 items to the end of class 4.0 - 4.49, and 65 to the end of class 4.5 - 4.99; therefore, the median must be in the latter class. Actually, it is the sixth item in that class (47 + 6 = 53) so the calculation would be as follows.

$$\text{Median} = \begin{matrix}\text{lower limit of}\\ \text{class containing}\\ \text{median}\end{matrix} \text{ PLUS } \left\{ \frac{\text{number of cases needed}}{\text{number of cases in class}} \text{ X class interval} \right\}$$

$$4.5 + \left\{ \frac{6}{18} \text{X } .5 \right\} = 4.67\%$$

The mode in a frequency distribution is calculated in much the same manner as the median, with the addition of

one factor, for despite the previous mid-point assumption, the values within a class tend to gravitate toward the point of greatest density, and account must be taken of this fact. The mode, or point of greatest concentration of the items, is obviously the class 4.0 - 4.49, with 20 items, in our example. The particular class containing the mode having been decided upon, the following is the calculation for obtaining the mode, where

L—Lower limit of group containing mode
X—Number of items in class *above* group containing mode
X'—Number of items in class *below* group containing mode
C—Size of class interval

$$\text{Mode} = L + \left(\frac{X}{X + X'} C\right)$$

In the case of our particular example, this gives us

$$\text{Mode} = 4.00 + \left(\frac{18}{18 + 17} \times .5\right) = 4.26\%$$

The three measures of central tendency which we have now obtained are:

Arithmetic Mean	—4.76%
Median	—4.67%
Mode	—4.26%

and from these we are able to make certain observations which, as anyone who will turn up a table of security yields in his daily newspaper will see, would be quite impossible without the making of some sort of analysis. Since this is an article on statistical method, and not on security analysis, we shall refrain from making the observations here.

We have now examined three measures which are representative of a mass of data, and which can be obtained with comparative ease. The most widely used of these is the arithmetic mean, but it is a dangerous procedure to form conclusions upon its evidence alone, since it is often unrepresentative of the mass of the data. The median is usually a better representation of the complete data, while the mode, when it can be determined, furnishes a typical from the mass. Used together, they furnish a check upon one another, and offer a more complete picture of all the items than it would be possible to obtain through the calculation of any individual measure. Practising accountants would be well advised to use them together more often, both as a check upon accuracy and as a source of information of considerable interest and value.

Form of Financial Statements

THE Accounting Research Committee of The Dominion Association of Chartered Accountants believes that the form of the financial statements of The Duplan Corporation as set out below, would be of interest to the members of the Association and the readers of The Canadian Chartered Accountant. On the publication of these statements the New York Journal of Commerce made the following comments:

"The report includes a financial statement of a new type which changes the usual assets and liabilities form of balance sheet into a style which more quickly and clearly shows the important aspects of the financial condition of the company.

"Banks and financial houses which have seen the new statement say that it is a pronounced advance in the presenting of financial information and will be of aid to experienced financial men as well as to the stockholders and the general public. For years the company has been a leader in using innovations in stockholder reports and on numerous occasions these have been said to be among the most effective produced in the country."

It is significant that the statement of assets and liabilities is not described as a balance sheet but rather as a statement of financial position. Unless it can be described as a balance sheet it is doubtful if this form could be used in the annual reports of Canadian companies. However, the form of presentation is an extremely interesting innovation and comment is invited from members of the Association particularly with respect to the question as to whether statements prepared in this form could be considered to be balance sheets within the meaning of the companies acts.

For the benefit of those unfamiliar with United States tax regulations it should be pointed out that the estimated refund of excess profits tax is realizable within the next year and therefore properly classified as a current asset at May 31, 1945.

STATEMENT OF OPERATIONS

The Duplan Corporation

Years Ended May 31, 1945 and May 31, 1944

	1945	%	1944	%
Net sales	$20,108,353	100.00	$17,570,508	100.00
Cost of goods sold	16,201,698	80.57	14,475,959	82.39

Provision for depreciation ...	399,283	1.99	387,722	2.20
	16,600,981	82.56	14,863,681	84.59
	3,507,372	17.44	2,706,827	15.41
Selling, general and administrative expenses	501,352	2.49	411,166	2.34
Profit on sales	3,006,020	14.95	2,295,661	13.07
Deductions from income:				
Reduction in book value of buildings			80,023	
Loss under leasehold	17,733		60,131	
Interest on notes payable ..	83,250		20,494	
Other deductions—net	57,814		26,732	
	158,797	.79	187,380	1.07
	2,847,223	14.16	2,108,281	12.00
Deduct provisions for:				
State income taxes	90,000		51,222	
Federal income taxes	260,000		290,000	
Federal excess profits tax—net	1,800,000		1,220,000	
Contingencies	50,000		50,000	
	2,200,000	10.94	1,611,222	9.17
Profit transferred to Earned Surplus .....$	647,223	3.22	$ 497,059	2.83
Earnings per share of Common Stock outstanding at end of year	$2.30		$1.54	

STATEMENT OF EARNED SURPLUS
Years Ended May 31, 1945 and May 31, 1944

	1945	1944
Earned Surplus at beginning of year .....$	2,785,109	$2,771,050
Profit for year	647,223	497,059
	3,432,332	3,268,109
Payments in cash:		
Dividends and redemption premium on Preferred Stock		240,000
Dividends on Common Stock (60 cents per share in 1945 and 90 cents per share in 1944)	165,175	243,000
In lieu of fractional shares on stock dividends	6,948	
	172,123	483,000
Distributions in Common Stock:		
2 dividends, each of 1 share for each 50 shares held, aggregating 10,586 shares, resulting in transfer to:		

Capital Stock—stated value of $5 per share	52,930	
Capital Surplus—market value on record dates, less $5 per share as above	174,231	
	399,284	
Earned Surplus at end of year (see Note C)	$3,033,048	$2,785,109

SUMMARY OF INCREASE IN WORKING CAPITAL

Additions during year:		
Profit		$ 647,223
Provision for depreciation		399,283
Provision for contingencies		50,000
Estimated refund of excess profits tax		172,500
Other		36,928
		1,305,934
Deductions during year:		
Reduction of notes payable (including prepayment of $200,000 due May 31, 1951)	$600,000	
Purchase of fixed assets	205,383	
Cash dividends on Common Stock	172,123	977,506
Increase		$ 328,428

STATEMENT OF FINANCIAL POSITION

The Duplan Corporation
At May 31, 1945 and May 31, 1944

CURRENT ASSETS	1945	1944
Cash	$ 952,177	$ 977,626
U.S. tax notes and certificates of indebtedness, with accrued interest	2,582,066	2,342,254
Estimated refund of excess profits tax	172,500	
Trade accounts receivable	1,482,240	937,612
Inventories, valued at or below the lower of cost or market:		
Raw materials, work in process and supplies	2,626,550	2,352,436
Woven fabrics	140,287	477,685
	7,955,820	7,087,613
LESS:		
CURRENT LIABILITIES		
Notes payable within one year	400,000	400,000
Trade acceptances and accounts payable	698,030	723,470
Accrued wages and other compensation	562,877	451,674
Provision for estimated federal taxes	2,195,980	1,763,798
Other accrued liabilities	148,923	103,265
Dividend payable	84,176	108,000
	4,089,986	3,550,207
WORKING CAPITAL	$3,865,834	$3,537,406
Current Ratio	1.94 to 1	1.99 to 1

		1945	1944
WORKING CAPITAL, brought forward		$3,865,834	$3,537,406
FIXED ASSETS (at cost, less reserves)			
Land		120,589	115,164
Buildings	$2,291,612		
Less depreciation	1,407,066	884,546	897,765
Machinery, plant and equipment	4,383,384		
Less depreciation	2,153,209	2,230,175	2,437,723
OTHER ASSETS			
Sundry investments (at cost or less)		14,184	15,692
Prepaid taxes and insurance		94,881	101,359
Estimated refund of excess profits tax			180,000
		7,210,209	7,285,109
LESS:			
NOTES PAYABLE (see Note A)		2,000,000	2,600,000
RESERVE FOR CONTINGENCIES		600,000	550,000
		2,600,000	3,500,000
EXCESS OF ASSETS over Liabilities and Reserves		$4,610,209	$4,135,109
Represented by:			
COMMON STOCK, outstanding 280,586 and 270,000 shares respectively (see Note B)		$1,402,930	$1,350,000
CAPITAL SURPLUS (resulting from stock dividends)		174,231	
EARNED SURPLUS (see Note C)		3,033,048	2,785,109
		$4,610,209	$4,135,109

NOTES TO FINANCIAL STATEMENTS

Year Ended May 31, 1945

Note A. Notes payable are due: $400,000 on each May 31 of 1947, 1948 and 1949, $500,000 on May 31, 1950, and $300,000 on May 31, 1951. Each year an amount equal to the net profits after taxes in excess of $500,000 is to be applied in prepayment of such notes in inverse order of maturity, but no more than $300,000 need be so applied in any year.

Note B. At May 31, 1945, the authorized capital stock consisted of 500,000 shares of common stock without par value, with a stated value of $5 per share. 350,000 of such shares had been issued, of which 69,414 shares were then held in the Treasury.

Note C. As long as the serial notes are outstanding dividends in cash out of the net profit of any fiscal year may not be more than 60% of such net profit nor more than $270,000 nor be declared if thereby the working capital would be reduced below $2,000,000.

Note D. The financial statements do not reflect any refunds which may result from claims for relief under Section 722 of the Internal Revenue Code as to excess profits tax for the year ended May 31, 1942, and subsequent years.

Depreciation on Real Estate

That there is no duty on the part of the tax department to make allowances for depreciation where such is not claimed, was one of the points expressed in a judgment of the Exchequer Court of Canada on August 21, 1945, in the case of Frederic J. A. Davidson, suppliant, and His Majesty The King, respondent. The discretionary power of the department, it was held, is merely to "allow" a reasonable amount.

In respect to an argument that the tax department went beyond its jurisdiction in taxing something which the act exempted, the court held that "there is a vast difference between an assessment that is invalid as being erroneous and one that is invalid as being made without jurisdiction to make it", and that the act provided adequate means for appeal.

The complete judgment, handed down by Thorson, J., is as follows:

THORSON J.:—The suppliant brings this petition of right to recover the sum of $11,144.77 as the total amount of overpayments of income tax alleged to have been made by him in respect of the years 1917 to 1934.

The suppliant is one of the executors of the estate of his father, Joseph Davidson, who died on March 1, 1901. His mother was entitled to an annuity of $3,000 per year out of the income of the estate for the support and maintenance of herself and her son, Judson France Davidson, now a co-executor of the estate, but after her death on November 18, 1922, the suppliant became entitled to half of the estate in his own right. The corpus of the other half was to be held for the issue of the suppliant, but he was entitled to receive the income from it subject to an annuity to his brother and co-executor, Judson France Davidson, the amount of which, after certain judicial proceedings to determine the meaning of certain clauses in the will, was agreed upon at $2,200 per year.

The suppliant has managed the estate since the death of his father. It was in a difficult and confused position when he took it over, consisting mainly of real estate, against which there were substantial liabilities.

After the *Income War Tax Act* came into effect in 1917 [1917 (Can.), c. 28] the suppliant made two sets of returns each

year, one known as the T-3 return as executor of the estate, and the other as the T-1 return as an individual taxpayer. By this time the suppliant had a secretary to assist him in the management of his affairs and those of the estate and it was one of the duties of the secretary to prepare the income tax returns. While he relied upon his secretary for the accuracy of these returns, it is also a fact that he checked the correctness of some of them himself and that he always kept in close personal touch with the administration of the estate.

The T-3 returns gave particulars of the income of the estate, the interest paid on borrowed money, the taxes paid on its properties, the general expenses incurred for repairs and maintenance, and the amounts claimed for depreciation. They also showed the amounts of income accruing to beneficiaries, including the suppliant, and the names and addresses of such beneficiaries. The T-3 was an information return. On the suppliant's own T-1 return as an individual taxpayer he included as his income the same amount as had been reported on the T-3 return as income accruing to him as beneficiary. In due course he received assessment notices from the taxing authorities. In some cases such notices showed that no further income tax was due, in others that further tax was payable, which the suppliant subsequently paid, and in others that an overpayment of tax had been made in which case they were accompanied by a refund. No appeal was ever taken from any of the assessments made in any of the years in question.

In his petition of right the suppliant claims that on the T-3 returns filed on behalf of the estate claims were made for depreciation on certain improved real estate owned by the estate, the income from which he was entitled to receive, but that on his own T-1 returns he by mistake neglected or omitted to deduct the amount so claimed for depreciation, but by mistake paid on the gross income without making such deduction which he was entitled to make. He also claims that his mistake was known to the taxing authorities and that it was the duty of the Minister and/or his officials, as soon as they discovered this overpayment in each year, to refund the amount so overpaid. The suppliant then sets out the amounts which he claims were overpaid in each of the years.

There is nothing to show how each of these amounts is arrived at nor were any of them proved.

It was contended for the respondent that even if the suppliant

ever had any right to relief such right was now barred by his failure to follow the procedure prescribed by the *Income War Tax Act*, R.S.C. 1927, c. 97. Section 58 of the Act, prior to its amendment in 1944, read as follows:

"58. Any person who objects to the amount at which he is assessed, or who considers that he is not liable to taxation under this Act, may personally or by his solicitor, within one month after the date of mailing of the notice of assessment provided for in section fifty-four of this Act, serve a notice of appeal upon the Minister."

Such notice must be in writing and be served by mailing the same by registered post addressed to the Minister of National Revenue at Ottawa. It must follow a prescribed form and set out clearly the reasons for appeal and all facts relative thereto. The section is, I think, wide enough to cover any cause of complaint by a taxpayer. Then s. 59 provides that the Minister shall duly consider the notice of appeal and affirm or amend the assessment and notify the appellant by registered post. If the taxpayer is dissatisfied with the Minister's decision, he may, by s. 60, within one month from the date of the mailing of the decision, mail to the Minister by registered post a notice of dissatisfaction together with a final statement of the facts, statutory provisions and reasons he intends to submit to the Court in support of the appeal. Section 61 provides for security for costs, s. 62 for the decision of the Minister upon receipt of the notice of dissatisfaction and statement of facts and s. 63 for the transmission of the necessary documents to the Exchequer Court of Canada. When these have been transmitted the matter is deemed to be an action in the said Court ready for trial or hearing. Then s. 66 provides:

"66. Subject to the provisions of this Act, the Exchequer Court shall have exclusive jurisdiction to hear and determine all questions that may arise in connection with any assessment made under this Act", etc.

This language is, I think, clearly wide enough to cover questions affecting the validity or correctness of the assessment and any complaint the appellant may allege or have against it. Then s. 67 provides:

"67. An assessment shall not be varied or disallowed because of any irregularity, informality, omission or error on the part of any person in the observation of any directory provision up to the date of the issuing of the notice of assessment."

Finally, the part of the Act dealing with appeals and procedure concludes with s. 69 as follows:

"69. If a notice of appeal is not served or a notice of dissatisfaction is not mailed within the time limited therefor, the right of the person assessed to appeal shall cease and the assessment shall be valid and binding notwithstanding any error, defect or omission therein or in any proceedings required by this Act." If the suppliant had any right to relief from the income tax levied against him by any assessment on the ground that he had made a mistake in his return he could have appealed from the assessment in accordance with the above procedure and the Court could have given effect to his rights if established by setting the assessment aside. Then, if he failed to recover the amount of tax he had overpaid the way would be clear for a petition of right by him without being faced by a valid and binding assessment. The suppliant never made any appeal from any of the assessments but now seeks to recover the amounts which he alleges he overpaid. Counsel for the respondent contended that the suppliant was barred from relief by s. 69. It is well established that if the law prescribes the procedure to be followed by an aggrieved person in obtaining relief such procedure must be followed. The assessments are, therefore, now binding upon the suppliant and his case must fail unless he can bring himself outside the implications of s. 69 and show his entitlement to relief apart from the procedure prescribed by the Act. The onus is on him and it is a heavy one for the language of s. 69 is very wide.

Counsel for the suppliant contended that the assessments made in each of the years in dispute were invalid. Two lines of attack upon their validity were laid down. In the first place, counsel relied upon s. 5(*a*) of the Act, as it stood prior to its amendment in 1940, which read as follows:

"5. 'Income' as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:—

"(*a*) Such reasonable amount as the Minister, in his discretion, may allow for depreciation,"

and upon the judgment of the Judicial Committee in *Pioneer Laundry & Dry Cleaners Ltd.* v. *Minister of National Revenue*, [1939] 4 D.L.R. 481 at p. 485, [1940] A.C. 127 at p. 136, where Lord Thankerton said:

"The taxpayer has a statutory right to an allowance in

respect of depreciation during the accounting year on which the assessment in dispute is based. The Minister has a duty to fix a reasonable amount in respect of that allowance . . . . ''

Counsel's argument was that under the section the suppliant had a statutory right to an allowance for depreciation, that the Minister was under a statutory duty to exercise his discretion in allowing a reasonable amount for depreciation, that the exercise of such discretion was a condition precedent to there being a valid assessment and that since there was no evidence that it had been exercised in the suppliant's case the assessments levying income tax against him were invalid and void *ab initio* and the suppliant was not barred from relief by s. 69, even although he had not appealed from any of the assessments.

There is more than one answer to this contention. The suppliant never made any claim for depreciation in respect of any of the amounts he reported as income from the estate. It is, I think, clear from s. 5(*a*) that it presupposes that a claim for depreciation has been made and that it is in respect of such a claim that the Minister is to exercise his discretion and allow a reasonable amount. The use of the word ''allow'' in the section connotes that there is a claim before the Minister for his consideration. It follows that where no claim for depreciation was made by a taxpayer there was no duty on the part of the Minister under s. 5(*a*) to make any allowance of depreciation to him for there was nothing before him in respect of which he could exercise his discretion. To suggest that the Minister must make an allowance for depreciation to a taxpayer even when he has not claimed any and that his failure to do so will render an assessment invalid and of no effect is, in my opinion, an utterly untenable proposition. If there was no duty on the part of the Minister to make an allowance for depreciation to the suppliant he could have no statutory right to it.

Even if the suppliant had claimed depreciation in respect of the amounts he reported as income from the estate it does not follow that he would have been entitled to it. This aspect of the case was not dealt with by counsel but is, I think, an important one. The depreciation allowance authorized by the Act is not an item of expenditure. It is quite a different thing from the expenses that may properly be offset against receipts in order to arrive at net profit or gain. The depreciation allowance is purely a statutory allowance authorized as a deduction or exemption from what would otherwise be taxable income.

Without the statutory authority for its deduction or exemption it would be taxable income. In that sense it is income that is exempt from tax but the true reason for such exemption is that, while it is included in what would otherwise be taxable income arrived at by deducting expenses from receipts, it is in reality an item of capital rather than one of income. That this is so is recognized by the Act itself, for s. 6(*b*) provides:

"6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

"(*b*) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence, except as otherwise provided in this Act;"

and it is, I think, clear that s. 5(*a*) comes within the exception referred to in s. 6(*b*). The depreciation allowance authorized by the Act is not limited as in the United Kingdom to depreciation to plant and machinery resulting from wear and tear but extends to any asset used by the taxpayer in the production of his income. Likewise, the allowance is restricted to the assets so used by the taxpayer. The principle underlying the depreciation allowance is that an asset used in the production of income will in time be used up in the course of such production and that it would be unfair to tax the taxpayer on the full amount of the income produced from the use of his asset, since to do so would mean taxing him not only on the income from use of the asset but also on that portion of the asset itself that has been used up in the production of such income. The allowance for depreciation is, therefore, in this sense an item of capital representing the diminution in value of the asset for use in income production and is granted in order to enable the taxpayer to keep his tax producing position intact—he will still have his asset with its diminished tax producing value but he will also have the depreciation allowance to make up for such diminished value. A taxpayer whose income comes to him otherwise than from the use of his assets is not entitled to any depreciation allowance in respect of such income. It follows that a beneficiary of an estate, in so far as he is entitled only to income from it, is not entitled to deduct any amount of depreciation in respect of such income, since it is not his assets but those of the estate that have been used in the production of such income. Any amount that may be allowed for depreciation, being an item of capital, enures to the benefit of the estate and those entitled to its corpus.

It should be noted that in respect of half of the estate it was to be held as to the corpus for the issue of the suppliant and the suppliant was entitled only to the income therefrom subject to the annuity to Judson France Davidson. In respect of the income from this half of the estate the claim of the suppliant that he made a mistake in failing to deduct depreciation from it fails completely for he had no right to any such deduction.

Moreover, the evidence is against the suppliant's contention that he was mistaken as to his rights in the matter of deducting depreciation allowance. As executor of the estate he made full and detailed claims for depreciation in respect of the various assets of the estate used in the production of its income, such as apartment blocks, houses and machinery and, although there is no direct evidence as to any action by the Minister in respect of such claims, it may fairly be assumed that they were allowed to the estate. Then, the suppliant in his own right claimed depreciation in respect of the assets he received from the estate in his own right. While the Court order dividing the estate was not made until December 15, 1930, it is clear that there was a division made earlier. This was done sometime after making the 1926 returns, for in the T-1 returns by the suppliant commencing with the year 1927 claims for depreciation were made by him in respect of assets which were formerly shown as assets of the estate. It will be remembered that the suppliant became entitled to half of the estate in his own right on the death of his mother in 1922. The returns show that the suppliant as executor of the estate always claimed depreciation in respect of the assets belonging to it; that from 1927 to 1934 he claimed depreciation in respect of the assets to which he was entitled in his own right; and that he never claimed any depreciation in respect of the amounts which were reported as income from the estate. His whole course showed a correct understanding of when he was entitled to claim depreciation and when he was not.

For the years 1927 to 1934 the suppliant included in his T-1 returns income from assets he had taken over from the estate in his own right and claimed and was allowed depreciation in respect thereof. He also included income from the other half of the estate the corpus of which was held for his issue. In respect of such income he was not entitled to any deduction for depreciation since it did not come from the use of any of his assets. If the amounts received by him from this half of the

estate during the said years exceeded the amounts he was entitled to receive as income from it, that was a matter of accounting between the suppliant and the estate and does not entitle him to any relief in these proceedings. I am unable to see any valid claim by the suppliant in respect of the years 1927 to 1934. Likewise, in respect of the years 1917 to 1922, prior to the death of his mother, the suppliant was entitled only to specific amounts of income from the estate and in respect thereof had no right to any depreciation allowance. His claim in respect of such years also fails. This leaves only the years 1923 to 1926 for consideration. For these years the suppliant's position was a different one. He had become entitled to half of the estate in his own right, and, inasmuch as the depreciation allowance to the estate was a capital item enuring to the benefit of the estate, he was entitled to a half interest in it as being part of the capital of the estate. His share of the capital of the estate, including the depreciation allowance made to it, was, as such, of course not subject to income tax.

The second attack upon the validity of the assessments may now be dealt with. Counsel for the suppliant contended that they were invalid in that they assessed as income that which was not assessable as such, that an attempt was made to tax that which the Act exempted from taxation, namely, the amount allowed to the estate for depreciation, and that in attempting to do so the taxing authorities went beyond their jurisdiction. Counsel relied upon such authorities as *Toronto R. Co.* v. *Toronto,* [1904] A.C. 809; *Donohue Bros.* v. *St. Etienne de la Malbaie,* [1924], 4 D.L.R. 361, S.C.R. 511; *Becker* v. *Toronto,* [1933], 4 D.L.R. 736, O.R. 843 and *Can. Oil Fields Co.* v. *Oil Springs* (1907), 13 O.L.R. 405. All these cases turn on the question of jurisdiction to assess and decide that an assessment made where there is no jurisdiction to make it is a nullity. In my opinion, they have no application to the present case at all. By s. 33 of the *Income War Tax Act* every person liable to taxation under the Act is required on or before the thirtieth of April in each year to deliver to the Minister a return in such form as the Minister may prescribe of his total income during the last preceding year. Then, by s. 54 it is provided that after examination of the taxpayer's return the Minister shall send a notice of assessment to the taxpayer verifying or altering the amount of the tax as estimated by him in his return. The suppliant made his T-1 returns in which he stated his income.

Each return contains a certificate by him that he has made a full and complete disclosure of his total income from all sources, that the information given therein and the statements of income and expenditure therein and all statements and information contained in any documents furnished therewith are true in every respect and that the expenditures claimed were actually incurred. The taxpayer's own return of his income, while not binding upon the Minister, may be the basis of the assessment made by him. It is reasonable that this should be so since the taxpayer knows better than anyone else what his income is. How, then, can it possibly be said that an assessment based upon the taxpayer's own return of his taxable income is an assessment made without jurisdiction to assess? The question carries its own answer. In my opinion, the fact that the taxpayer's own return of his taxable income may be the basis from which the assessment may be made distinguishes this case from those relied upon by counsel. The taxpayer may make an error in his return by including as income that which may really be capital or by failing to claim a deduction to which he may be entitled, and he may be able on appeal, in the manner prescribed by the Act, to show such error and have the assessment set aside but there is a vast difference between an assessment that is invalid as being erroneous and one that is invalid as being made without jurisdiction to make it. The latter is a nullity and can be attacked in collateral proceedings, but the former is not a nullity and is valid until it is set aside in proceedings taken in conformity with the Act. If the suppliant erroneously included in his T-1 returns of his income items to which he was entitled not as income but as capital any remedy he might have had was by way of appeal from the assessments. The contention of his counsel that each of the assessments for the years 1917 to 1934 was a nullity cannot be accepted. Both attacks on the validity of the assessments fail.

There remains for consideration one other contention. Counsel for the suppliant relied strongly on s. 53 which provides as follows:

"53. The returns received by the Minister shall with all due despatch be checked and examined.

"2. In all cases where such examination discloses that an overpayment has been made by a taxpayer the Minister shall make a refund of the amount so overpaid by such taxpayer", etc.

He contended that the section gave the suppliant a statutory

right to a refund of the amounts of income tax overpaid by him. His argument was that the returns made by the suppliant disclosed overpayments of income tax by him, that there was a statutory duty on the Minister to refund such overpayments and that the suppliant had a statutory right to receive such refunds. This is the only section in the Act under which the suppliant has any possible hope for success, but he must show clearly that his case comes within its terms. It is, I think, clear that the primary purpose of the section was to simplify the process of making refunds. Without some such section no refund of an overpayment of tax could be made without an Order in Council under the *Consolidated Revenue and Audit Act*, R.S.C. 1927, c. 178 [now 1931 (Can.), c. 27]. Where it was clear from the returns that an overpayment had been made by a taxpayer it was deemed desirable that a refund should be made without the necessity of passing an Order in Council and the Minister was directed to make such refunds. While that was the primary purpose of the section, the language is mandatory and I see no reason why the reasoning that prevailed in the *Pioneer Laundry* case (*supra*) in respect of s. 5(*a*) should not also govern in respect of s. 53(2). If there was a statutory duty on the Minister to make a refund, there was a statutory right in the taxpayer to receive it.

Counsel for the respondent argued that s. 53(2) referred only to examination of returns made by the taxpayer. If this be so, the suppliant has no case under it, for there is nothing in any of his T-1 returns that could disclose any overpayment of income tax by him. Counsel for the suppliant contended, however, that more than merely the taxpayer's returns were referred to. The sections preceding s. 53 deal with returns of various kinds, some taxpayers' returns and others information returns, such as the T-3 returns. Section 53 requires the checking and examination of all returns. The interpretation of what is meant by "such examination" in s. 53(2) depends upon what is involved in the examination. The T-1 return is before the assessor for examination; he sees in it an item of income from an estate; this takes him to the T-3 return of the estate. The evidence of Mr. Patterson in the present case was that the T-3 returns were always checked against the T-1 returns. I am, therefore, of the view that the term "such examination" in s. 53(2) means the examination not only of the taxpayer's T-1 return but also of any other return that would normally be looked at in the course of the examination and that in the

present case it would include the T-3 return made by the suppliant as executor of the estate.

What did such examination disclose? The T-3 returns show for each year the amounts of income accruing to the beneficiaries. In the earlier years there are six beneficiaries, but in the later ones there are only two, the suppliant and his brother, Judson France Davidson. In most of the years the total amount shown as accruing to beneficiaries exceeded the amount of net income of the estate after deduction of the depreciation allowance to it. This fact was apparent to the tax official who examined the returns. The 1922 T-3 return carries the following notation: "Excess of net Income paid Beneficiaries out of Depreciation account. W". The 1923 return carries a similar notation. On the 1924 return the notation is "Excess Income shown as paid to Beneficiaries is paid out of Depreciation Fund and is taxable". Similar notations with some variations in language appear on the T-3 returns for the following years. Counsel for the suppliant contended that it was apparent on the face of the two returns taken together that the suppliant was making overpayments of income tax, that the notations were proof that the taxing authorities were aware of such overpayments and that the suppliant came within the terms of s. 53(2). I am unable to accept this contention. All that the T-3 returns show is that the total amounts of income accruing to beneficiaries exceed the amounts of net income of the estate left after deducting the amounts of the depreciation allowances. This is not enough to warrant a claim under s. 53(2).

In my opinion, s. 53(2) was meant to cover cases where it is clear from the examination of the returns that there has been an overpayment of income tax by the taxpayer and where the exact amount of such overpayment is clearly ascertainable, as, for example, where the overpayment was due to an error in computation of rates or calculation of amounts or failure to make or subtract specified deductions. It does not cover cases involving an adjudication as to rights. It may be that the suppliant as executor of the estate made a mistake in distributing as income more than he should have distributed as such or in distributing as income that which should have been distributed only as capital but that is a matter of estate administration. And it may well be that the suppliant has paid more income tax because of the distributions by the estate than he might have had to pay if the distributions had been made

differently. The fact is that the distributions by the estate were made, whether rightly or wrongly, as distributions not of capital but of income and were reported as such. Likewise, they were received and reported as such by the suppliant and it is this receipt, rather than the source from which it came, that is of primary concern. There was no distribution or division of the capital of the estate until after 1926. It might also be debatable whether, if gross income from the estate was being distributed to beneficiaries as income, there was any right to depreciation allowance to the estate since the purpose of such allowance was not being observed, namely, the maintenance of the estate's tax producing value. I pass no opinion on these questions. Certainly the taxing authorities were not called upon to make an adjudication in respect of them in order to determine whether the returns disclosed that the taxpayer had paid too much tax. Such adjudication might have been made by the Court if an appeal from the assessment had been made, but that has nothing to do with the question whether an overpayment of tax was disclosed by the examination of the returns. It must be the examination of the returns, and not the determination of some other matter, that discloses the overpayment.

Moreover, before the suppliant can succeed under s. 53(2) he must show not only that the examination of the returns discloses an overpayment of income tax by him but also that it discloses the exact amount of such overpayment so that the Minister may be able to make a refund of "the amount so overpaid". The suppliant cannot comply with this requirement of the section. It would, in my opinion, be quite impossible, even if it were assumed that there had been an overpayment of tax by the suppliant, to take the returns for any one year and ascertain the amount of such overpayment. It is not possible to determine how the amounts of income of the suppliant are arrived at, nor can it be ascertained from the returns how much of it was income to which he was entitled as such or how much of it came out of the depreciation fund or reserve or from some other source.

In my judgment, not only did the examination of the returns in this case not disclose any overpayments of income tax by the suppliant, having regard to the distributions made by the estate, but also, even if that were not so, it would be impossible for the Minister to determine from the returns what refund to make. The suppliant's case falls outside s. 53(2) on both grounds.

While it may well be that the suppliant has in the result paid more income tax than he would have been called upon to pay if he had kept his administration accounts of the estate in better order and made its distributions differently, he has only himself to blame for this state of affairs. Having failed to take advantage of the provisions of the Act by way of appeal from the assessments, by which he might have obtained relief from his mistakes of accounting or distribution, he is now barred from relief by s. 69. Under the circumstances, the judgment of the Court must be that the suppliant is not entitled to any of the relief sought by him in his petition of right and that the respondent is entitled to costs.

Judgment accordingly.

Current Accounting Literature

By Frank S. Capon, C.A.

It is refreshing to read an article as balanced, as dispassionate, as that on punched card accounting by T. A. Chapin in the October 1st N.A.C.A. Bulletin (385 Madison Avenue, New York). The purpose of the article, to use his own words, is neither to advocate nor to discourage the adoption of punched card accounting systems. Here are both the pros and cons, the advantages and disadvantages, the possible achievements and the limitations, the satisfaction and the disappointments. Of particular interest is the section dealing with the preliminary staff work necessary before setting up a system, the establishment of procedures, the decisions on the scope of the system, and the drafting of manuals.

The Place of Internal Auditing

In the same bulletin, D. M. Sheehan, comptroller of Monsanto Chemical Co., has presented an admirable review of the function of internal auditing, particularly in relation to internal control.

Small Office Problems

Small offices are generally inefficient, not because the personnel lacks capacity, but because the conditions of the office tend to discourage the development of efficient methods. Volume is not sufficient to justify the use of mechanical devices, one man must often undertake the humblest and also the most senior accounting duties him-

self, and then he usually knows so much that he cannot bother keeping proper supporting data or explanations. These special problems are discussed by G. T. Kleinau in the 15th October N.A.C.A. Bulletin, and he develops a surprising one book, ringbook, accounting system for small offices that is well worth study by those who are concerned with the necessary inefficiencies of small scale accounting.

Incentive Income Tax Plan

An entirely new tax structure, named by its proposer F. W. Main, the incentive income tax plan, is submitted in the November issue of Taxes — The Tax Magazine (Chicago). The too brief explanation given with the plan takes a lot for granted, and a very much stronger case could have been built up. Nevertheless, open-minded tax men should at least give consideration to all new suggestions, and the above plan certainly contains some interesting points.

Accounting for Reparations

In a brief article in the October Journal of Accountancy (13 East 41st Street, New York), N. L. McLaren has lifted the curtain enough to give us a glimpse of some of the accounting problems involved in the collection of reparations from Germany. The development of the new monetary unit "repunit", and the method of handling this inflationary "currency" without disturbing values of other currencies, are worthy of a longer and more detailed report.

Corporate Accounting Principles

Many of the fine points from the statements on policy, official bulletins, and other accounting releases by the American Institute of Accountants, the American Accounting Association, and the Securities and Exchange Commission are contrasted in the October Journal of Accountancy in the form of a discussion on corporate accounting policy. Accountants interested in this subject should not miss reading this invaluable contribution to accounting discussions.

New Opportunities of the Profession

John L. Carey, Secretary of the American Institute, repeats the oft-heard statement that "no profession can be stronger than its personnel" in commenting in the October Journal of Accountancy on the potential future of the profession and the straight and narrow path we must tread if

we are to achieve the goal dangled before our eyes. Summing up his points under the headings personnel, professional standards, public relations, and co-ordination of accounting activity, Mr. Carey plants our feet on the ground by reminding us that there is a price to pay for anything worthwhile.

Financial Controls

Although articles on financial controls are legion, now and again one stands out from the mass. Such a standout is the article on "Financial Controls and their Significance to Management" by G. C. Ellis in the October issue of The Controller (1 East 42nd Street, New York). Controls are defined as those devices which enable management to plan its operations, and conversely, a planned operation is the only operation that can be controlled. Mr. Ellis summarizes sales controls (both as to volume and selling expenses), operating controls, cost controls, and systems, and sums up with a pithy paragraph on what financial controls provide .... they provide one means of presenting facts to men .... they provide one means by which the individual can be made to think for himself. Here are all the real responsibilities and aims of the industrial accountant—as opposed to the bookkeeper—boiled down to less than four pages.

Internal Reports to Management

Financial statements do not and cannot provide management with sufficient data on which to make decisions and base financial policy—hence the need for internal narrative reports, the principles of which are outlined by Mr. D. Littler in the October issue of The Controller. This article will provide suggestions for all industrial accountants, including those who are already preparing well developed reports, and the statistics on the type of statements and reports prepared in a large group of companies, the dates of release, the make-up of the contents and so forth are most interesting.

Income Tax Deductions

INCOME tax deductions of four kinds, claimed by Siscoe Gold Mines Limited, but disallowed by the tax department, went before the Exchequer Court of Canada, which, in judgment given by Thorson, J., on November 12, 1945, upheld the department.

In the income tax assessments levied against it for various years from 1929 to 1937, certain disbursements and expenses made and incurred by the company were disallowed as deductions from its income. The appeals from these assessments were brought because of such disallowances.

The items were of four kinds, as follows: First, legal expenses paid in connection with title to the property. Second, exploration and development work on a neighbouring property. Third, payment to one of the directors on the ground of past services. Fourth, expense of gold medals distributed to directors and other persons.

The deductions were all disallowed, the reasons in brief being as follows. Regarding the legal expenses, the judgment said in part: "The business of the appellant was that of gold mining and it earned its income from that business. The legal expenses incurred had nothing to do with the business of gold mining or with the earning of income therefrom." Second, regarding work on other claims, the judgment said: "I am quite unable to see by what right the appellant can deduct these expenditures. It is quite clear that they were incurred for the purpose of determining whether the claims should be acquired as capital assets. If the option had been taken up, additional capital assets would have been acquired and the expenditures made would clearly have been capital outlays or payments on account of capital and could not have been deducted. The fact that it was decided to abandon the option and not to acquire the claims cannot change the character of the disbursements. They were losses incurred in connection with a capital venture." Third, after quoting from the resolution authorizing the payment, the judgment said: "It is obviously not deductible as an expense for there was no obligation to make it . . . In reality the expenditure, although put on the basis of payment for past services, was made in repayment for stock loaned to the appellant in connection with its financing." Fourth, the

expense of gold medals was deemed to be not "necessarily" laid out or expended, and it had nothing to do with the earning of the appellant's income.

Appeal on Expense Disallowance

Ministerial discretion in respect of deductible expenses was the subject of a judgment of the Exchequer Court of Canada in Nicholson Limited, appellant, and the Minister of National Revenue, respondent. The decision was expressed by Thorson, J., on October 5, 1945.

The appeal from the assessments for income and excess profits tax for the taxation years ending January 31, 1940 and 1941, was brought by the appellant because certain amounts of the salaries paid to its executive officers were disallowed as deductible expenses by the Commissioner of Income Tax.

The judgment emphasizes that the court was not concerned with the decision of the minister as such, but with the correctness of the assessment under appeal. It concludes as follows:

"It was not argued before me that the minister in making his determination under section 6(2) had not exercised his discretion on proper legal principles and there is nothing in the case to indicate or suggest that he did not do so. The determination cannot be challenged on any such ground. Counsel for the appellant argued on the facts that the minister did not correctly exercise his discretion in that he did not give proper consideration to the increase in the appellants' business and profits and did not make a fair allowance for overtime work by the directors. The appellant had the fullest opportunity of placing its case before the minister and the facts were all before him before he made his determination. The matters referred to by counsel are among the very considerations that parliament has left to the discretion of the minister. The conclusion which he reached after exercising his discretion on proper legal principles is not open to review by the court.

"The appellant has failed to show that the assessments under appeal were incorrect either in fact or in law and its appeal must be dismissed with costs."

Beneficiary's Right to Mine Depletion

THE identity and origin of mining dividends received by a trustee are not lost in the general income, and the beneficiary is entitled to depletion allowance, concluded the Exchequer Court of Canada in the case of Grace Gilhooly, appellant, and The Minister of National Revenue, respondent.

The appellant in this case was a beneficiary deriving income from the estate of John McMartin, of Cornwall, Ontario, who died in 1918. A large portion of the estate was in shares of Hollinger Consolidated Gold Mines Limited. The appellant claimed the right to deduction of allowances for depletion. The respondent claimed that the income, being from an estate, was not entitled to such deduction.

In giving judgment on August 24, 1945, Deputy Judge Cameron concluded as follows:

"The income is clearly that of the beneficiary and not that of the trustee and the beneficiary derives it from mining. This appellant has the right to receive from the trustee her proportion of the income from the mining shares set apart to produce income for her and the other life tenants .. The identity and origin of the mining dividends received by the trustees are not lost or merged in the general income; books are kept and the amounts so received accurately recorded. Nor do I think that the mere fact that the work of the department would be increased by such an interpretation (due to the necessity of going into the trustees' accounts) is a sufficient reason for denying the statutory deduction. The work would probably be more difficult but that is not a valid reason for denying the statutory right. It is a matter of mathematical calculation."

He concluded: "For the reasons which I have set forth above, I am of the opinion that the appellant must succeed. There will, therefore, be judgment allowing the appeal and declaring that the appellant is entitled for the years 1937 to 1941 to deduct from her income the allowances in force for the respective years as provided for in section 5 (1) (a) of the Income War Tax Act and as allowed by the minister to registered shareholders of the mine mentioned. The appellant is also entitled to be paid her costs after taxation."

Personals

Davis, Boyce & Company, chartered accountants, of Ottawa and Montreal, announce the appointment of T. Gordon Dalglish, C.A., as resident partner in Toronto with offices located temporarily at 86 Bloor Street West, Toronto.

James F. Gibson, F.C.A., formerly of the Income Tax Division, Department of National Revenue, announces the commencement of professional practice with office temporarily at 109 Williamson Road, Toronto.

Lloyd G. Arnold, C.A., announces the opening of an office for the practice of his profession at 67 Yonge Street, Room 603, Toronto.

Gordon S. J. Payne, C.A., and Philip T. R. Pugsley, C.A., wish to announce that on October 1, 1945, they entered into partnership with John Alfred Ryan, C.A., for the purpose of practising their profession as chartered accountants. Notwithstanding the untimely death of Mr. Ryan on October 17, 1945, the surviving partners will continue to practise under the name of Ryan, Payne & Pugsley, chartered accountants, with offices at 524 University Tower, Montreal.

Stiff Bros. & Sime, chartered accountants, Toronto, announce the admission to the partnership of Jack W. Nott, B. Com., C.A., formerly of the corporation assessment branch of the taxation branch of the Department of National Revenue, Toronto.

Obituaries

The Late Lieutenant James Arthur Cook

The Society of Chartered Accountants of the Province of Quebec regrets to announce the accidental death of Lieutenant James Arthur Cook, in Detroit, Michigan, on October 18, 1945.

Lieutenant Cook served his apprenticeship with the firm of Sharp, Milne & Co. and became a member of the Society in 1941. Subsequent to passing his final examination, he enlisted for active service in the Canadian Army. He proceeded overseas in 1943 and had been back in Canada only a month prior to his death in an automobile accident in which both he and his wife were killed.

To his family the Society extends sincere sympathy.

The Late John Alfred Ryan

The Society of Chartered Accountants of the Province of Quebec regrets to announce the death on October 17, 1945, of John Alfred Ryan, in his sixty-fifth year.

A veteran of world war I, Mr. Ryan was demobilized in 1918 with the rank of Captain, subsequently entering the employ of Price, Waterhouse & Co., to serve his apprenticeship. After attaining his degree he became a partner in the firm of Coleman, Haskell & Co., leaving that firm to practise alone. At the time of his sudden death he had just formed the partnership of Ryan, Payne & Pugsley. Mr. Ryan took a keen interest in the affairs of the Society, serving on the Council during the years 1942-1944. His fine character earned for him the affection of all his confreres and his passing is a great loss to the profession.

To his family, the members of the Society offer their sincere sympathy.

The Late Thomas William Saul

The Institute of Chartered Accountants of Manitoba regrets to announce the death of Mr. Thomas W. Saul, a partner of the firm of Rankin, Saul & Thornton, at the age of 79 years.

Mr. Saul was admitted to the Manitoba Institute in 1913 while with the firm of Webb, Read & Hegan. He later entered into partnership with the late E. V. Chaplin, C.A., then became a partner of Messrs. Stirling & Rankin, and subsequently the firm name was changed to Rankin, Saul & Thornton.

Age and illness took their usual toll and for some years past Mr. Saul, although attending to his office duties, was in a low state of health. His pleasing and genial personality won him many friends who mourn his passing. His son, Thomas E., and his grandson, Thomas A., are both members of the Institute, the only instance to date of three generations of Manitoba chartered accountants.

Mr. Saul served on the Council of the Manitoba Institute during the years 1924 to 1926 and 1928 to 1940, was vice-president from 1936 to 1938 and president from 1938 to 1940. He served on the Council of the Dominion Association during the years 1937 to 1940.

The Manitoba Institute extends sympathy to Mrs. Saul and the family.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

By the time this issue of the magazine is in their hands our readers will have emerged, shaken but, we hope, unscathed, from the ordeals with which the early part of December is associated in the minds of the younger members of our profession. We extend our sincere good wishes to all who write the examinations and especially to the ex-servicemen, and we hope that none will allow a conviction of failure to mar enjoyment of such holidays as Christmas and New Years may afford.

* * *

In a recent issue of *"The Manchester Guardian"*, Professor A. C. Pigou essayed an answer to the question: If hours are reduced from fifty to forty per week and hourly wages are raised in the ratio of five to four so as to maintain the former level of weekly earnings what will the consequences be (ignoring the suggestion that forty hours a week may be as productive as fifty hours per week in the sense that fifty hours would certainly be more productive than a hundred hours)?

He points out first that with the present abnormal shortage of labour this policy will not lead (as it normally would do) to a reduction in the number of workers whom employers would find it profitable to engage and hence to a drop in the aggregate earnings of all wage earners employed and unemployed together. If a particular group of workers secures an increase and others do not this group benefits at other people's—chiefly at other work-people's expense, not directly but as a result of a complicated chain of price reactions. "Whether or not this is a socially desirable result cannot be decided in general terms. If the group of work-people affected have so far been getting a raw deal relatively to other groups, it is; in the contrary case it is not."

If the policy is adopted by wage earners as a whole we may expect that money prices will go up roughly in proportion to money wage rates, in which event wage earners will be no better and no worse off than they would have been

if money wage rates had been left alone. "The group of work-people in one occupation pick the pockets of other groups, but have their own pockets picked by these others to an equivalent extent." The rise in prices has however a secondary result in that a change is produced in the relative position of debtors and creditors. "As things are at present, much the most important debtor is the state—that is to say, the taxpayers—and much the most important creditors are the holders, large and small, of the various types of government war loan. The policy of pushing up money wage rates, and so prices, means, then, that the recipients of war-loan interest are mulcted for the benefit of the taxpayer. If by a miracle it happened that the ratio between interest claims on the state and tax obligations was the same for everybody, no mulctor—may the word be pardoned?—would mulct anybody but himself and the distribution of real income among persons would be unaffected." But in fact this ratio differs widely with different people and consequently a good deal of uncancelled mulcting would take place. Professor Pigou concludes: "If it is desired to alter the distribution of real income as between poorer and richer people, more direct and effective ways of doing that are available".

* * *

PUZZLE

A farmer's wife drove to town to sell a basket of eggs. To her first customer she sold half her eggs and half an egg. To the second customer she sold half of what she had left and half an egg. And to the third customer she sold half of what she *then* had left and half an egg. Three eggs remained unsold and no eggs had been broken. How many eggs were there originally in the basket?

* * *

ANSWER TO LAST MONTH'S PUZZLE

The logs will have made seven revolutions. The distance the garage will have moved forward with each revolution is not equal to the circumference of the logs but to twice this figure. The motion can be revolved into two parts. If the logs were lifted off the ground and supported at their centres (the centres remaining stationary) one revolution of the logs would move the garage eighteen inches. If the rollers were on the ground and without the garage one revolution would carry the centres of the logs forward

eighteen inches. Combining these two motions it can be seen that one revolution of the logs will carry the garage forward a distance of three feet.

* * *

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1944

Accounting II, Question 4 (20 marks)

A, B and C were partners. On 1st July 1942 they decided to sell their business.

The following schedule shows the ratio in which profits were shared and the amount of their capital accounts as determined by the partnership agreement:

Name	Share in Profit or Loss	Capital Account 1st July 1942
A	2/5 or 40%	$90,000
B	3/10 " 30%	50,000
C	3/10 " 30%	20,000

The assets and liabilities included the following balances:

(1) A debit balance in C's account of $3,000 representing a withdrawal of his share of the profits earned in 1942.

(2) Credit balances in A's and B's accounts of $1,000 and $2,000 respectively, representing the balance of their salary accounts.

The net assets, exclusive of partners' personal accounts and of $20,000 cash in bank, were sold for $100,000. Of this amount $20,000 was received immediately in cash, and the balance is to be paid in two equal annual instalments without interest.

The partners agreed that A and B on the first distribution should be entitled to their salary accounts as well as their proportionate shares of the profits for 1942.

Required:

You are required to submit a schedule showing how the cash could be distributed as it became available. Cents may be disregarded in the solution of the problem.

SOLUTION

Date 1942	*Item*	*Total*	*A*	*B*	*C*
1st July	Cash in bank	$ 20,000			
	Received on sale of assets	20,000			
	Available cash	$ 40,000			
	To be disbursed re share of profits for 1942	$ 7,000	$ 4,000	$ 3,000	
	Balance of salary accounts	3,000	1,000	2,000	
	Together	$ 10,000	5,000	5,000	

Balance available	$ 30,000			
Partners' capital accounts	160,000	90,000	50,000	$20,000
Indicated possible loss	$130,000	52,000	39,000	39,000
Excess or *deficiency*	$ 30,000	38,000	11,000	*19,000*
Allocation of deficiency on basis of capital accounts		*12,214*	*6,786*	19,000
Distribution to be made	$ 30,000	25,786	4,214	
Total payment	$ 40,000	$30,786	$9,214	

1943					
1st July	Cash received	$ 40,000			
	Previous distribution	30,000			
		$ 70,000			
	Partners' capital accounts at 1st July 1942	160,000	90,000	50,000	20,000
	Indicated possible loss	$ 90,000	36,000	27,000	27,000
	Excess or *deficiency*	$ 70,000	54,000	23,000	*7,000*
	Allocation of deficiency on basis of capital accounts		*4,500*	*2,500*	7,000
		$ 70,000	49,500	20,500	—
	Distribution made 1st July 1942	30,000	25,786	4,214	
	Distribution to be made 1st July 1943	$ 40,000	$23,714	$16,286	

1944					
1st July	Cash received	$ 40,000			
	Previous distribution	70,000			
		$110,000			
	Partners' capital accounts at 1st July 1942	160,000	90,000	50,000	20,000
	Loss on dissolution	50,000	20,000	15,000	15,000
	Balance	$110,000	70,000	35,000	5,000
	Previous distributions	70,000	49,500	20,500	
	Distribution to be made 1st July 1944	$ 40,000	$20,500	$14,500	$5,000

PROBLEM II

FINAL EXAMINATION, DECEMBER 1944

Accounting III, Question 3 (25 marks)

T. Jones and R. Smith are equal partners in a contracting firm which went into liquidation on 30th June 1944, the end of its financial year. The following is a trial balance of the books at that date:

	Dr.	Cr.
Bank	$ 1,000	
Accounts receivable	10,000	
Contracts in progress	6,000	
Supplies on hand	1,500	
Building	10,000	
Equipment	33,000	
Prepaid taxes	200	
Prepaid insurance	300	
Accounts payable		$25,000
Receipts on account of contracts in progress		3,000
Unpaid wages		600

Sales tax		100
Mortgage on buildings and equipment		5,000
Reserve for depreciation on buildings		1,000
Reserve for depreciation on equipment		15,000
T. Jones capital account		5,000
T. Jones drawings account		100
R. Smith loan account		800
R. Smith capital account		5,000
R. Smith drawings account		1,400
	$62,900	$62,000

Required:

From the above and the following additional information prepare the statement or statements you consider should be submitted to a meeting of creditors.

In addition to their respective interest in the partnership the private financial position of the partners is as follows:

	Assets	Liabilities
T. Jones	$ 6,000	$6,500
R. Smith	10,000	7,000

The Accounts Receivable are estimated to be 75% good, 15% doubtful (may realize 33-1/3%) and 10% bad. Eighty percent of the good accounts receivable is pledged as security against an accounts payable of $5,000.

The selling price of the contracts in progress is $9,000 and a further expenditure of $1,500 is required to complete them in addition to $1,000 of the supplies already on hand. The balance of the supplies is estimated to realize $300. An offer is received for the buildings and equipment which will give the partnership a net amount of $6,000 after all the necessary adjustments in connection with the transaction have been made.

Liquidation expenses are estimated to be $1,000.

JONES & SMITH IN LIQUIDATION
Statement of Affairs as at — 30th June, 1944
ASSETS

Book Value			Expected to realise	Shrinkage
	Free Assets			
$ 1,000	Bank		$ 1,000	
6,000	Contracts in progress	$ 6,000	6,000	$ *500*
	Additional costs, see below	2,500		
		$8,500		
	Selling price	9,000		
	Profit	$ 500		
	Selling price	$ 9,000		
	Received as per contra	3,000		
		$ 6,000		
$ 1,500	Supplies	$ 1,500		
	Used on contracts	1,000		
		$ 500	300	200

	Pledged Assets			
$10,000	Building	$10,000		
33,000	Equipment	33,000		
200	Prepaid taxes	200		
300	Prepaid insurance	300		
		$43,500		
	Deduct Reserve for depreciation per contra	16,000		
		$27,500		
	Deduct Mortgage, per contra	5,000		
		$22,500	6,000	16,500
	Partly Pledged Assets			
$10,000	Accounts receivable			
	75% good	$ 7,500		
	15% doubtful, worth say	500		
	10% bad	—		
		$ 8,000		
	Deduct Pledged per contra	5,000	3,000	2,000
			$16,300	$18,200
$62,000				
	R. Smith, net private assets		3,000	
			$19,300	
	Deduct Additional costs of			
	Contracts	$ 1,500		
	Wages	600		
	Sales tax	100		
	Liquidation expenses	1,000	3,200	
	Estimated amount available for unsecured creditors being 80½ on 1.00		$16,100	
	Deficiency		3,900	
			$20,000	

LIABILITIES

Book Value			Expected to rank
	Secured		
$ 5,000	Mortgage—per contra	$ 5,000	
$ 3,000	Receipts on contracts in progress per contra	$ 3,000	
	Partly Secured		
$ 5,000	Accounts payable—per contra	$ 5,000	
	Preferred Claims		
600	Wages	$ 600	
100	Sales tax	$ 100	

	Unsecured Creditors		
20,000	Accounts payable		$20,000
1,000	Reserve for depreciation, building per contra	$ 1,000	
15,000	" " " equipment " "	$15,000	
5,000	T. Jones capital account		
100	" " Drawings account		
800	R. Smith Loan account		
5,000	" " Capital account		
1,400	" " Drawing account		
$62,000			$20,000

Deficiency Account	*Dr.*	*Cr.*
Shrinkage as per statement of affairs	$18,200	
Liquidation expenses	1,000	
Smith private assets		$ 3,000
Partners loan, capital and drawing accounts		12,300
Deficiency per statement of affairs		3,900
	$19,200	$19,200

PROBLEM III
FINAL EXAMINATION, DECEMBER 1944

Accounting III, Question 6 (5 marks)

The profit and loss accounts of The Dally Co. Ltd. for the years 1942 and 1943 are as follows:

	1942	1943
Sales	$1,200,000	$1,500,000
Cost of sales	960,000	1,170,000
Gross Profit	$ 240,000	$ 330,000
Selling expenses	$ 75,000	$ 80,000
General and administrative expenses	45,000	50,000
	$ 120,000	$ 130,000
Net Profit	$ 120,000	$ 200,000

Required:

Prepare a statement accounting for the increased gross profit assuming that the manufacturing cost per unit was the same in both years.

SOLUTION

1942	Cost of sales	$ 960,000	
1942	Sales	1,200,000	125% of cost of sales
1942	Gross profit	240,000	20% of sales
1943	Sales at 1942 prices $1,170,000 x 125	$1,462,500	
1942	Sales actual	1,200,000	
	Sales increase at 1942 prices	$ 262,500	

	20% thereon, being profit due to increased volume		$52,500
1943	Sales actual	$1,500,000	
1943	Sales at 1942 prices	1,462,500	
	Increased profit owing to increased selling price		37,500
			$90,000

Book Reviews

Corporation Finance. By C. A. Ashley. Published by The MacMillan Company of Canada, Ltd., 70 Bond Street, Toronto, Ontario. 62 pages. 75 cents. Reviewed by the editor.

In the preface to this booklet the author, who is professor of accounting in the University of Toronto, says: "A Canadian book on corporation finance is long overdue. Because of the pressure of work, and of a bottleneck in the binding business, the first five chapters of a larger book are published in this form." The booklet, therefore, no doubt is part of a book which is intended to appear later. The five chapters deal with forms of business organization, formation and control of companies, shares, borrowing—bonds, and financial structure. Illustrations are almost entirely from Canadian sources.